NEW ZEALAND

REPORT

OF THE

ROYAL COMMISSION

ON

MONETARY, BANKING, AND CREDIT SYSTEMS

1956

BY AUTHORITY:
R. E. OWEN, GOVERNMENT PRINTER, WELLINGTON, NEW ZEALAND—1956

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REPORT

OF THE

Royal Commission on Monetary, Banking, and Credit Systems

Presented to the House of Representatives by Command of His Excellency

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CONTENTS

Royal Commission to Inquire Into and Report Upon Matters Concerning the Monetary, Banking, and Credit System of New Zealand

ELIZABETH THE SECOND, by the Grace of God of the United Kingdom, New Zealand and Her Other Realms and Territories Queen, Head of the Commonwealth, Defender of the Faith:

To Our Trusty and Well-beloved the HONOURABLE MR JUSTICE ARTHUR TYNDALL, C.M.G., of Wellington, Judge of the Court of Arbitration; WILLIAM GORDON VICTOR FERNIE, of Christchurch, Company Manager; RONALD MACGREGOR HUTTON-POTTS, of Invercargill, Managing Editor; CLEMENT GEORGE TROTTER, of Hawera, Managing Director; GORDON GRAHAM GIBBS WATSON, of Wellington, Barrister; and ERNEST DAWSON WILKINSON, of Auckland, Public Accountant: GREETING:

KNOW Ye that we, reposing trust and confidence in your integrity, knowledge, and ability, do hereby nominate, constitute, and appoint you, the said

Arthur Tyndall,
William Gordon Victor Fernie,
Ronald Macgregor Hutton-Potts,
Clement George Trotter,
Gordon Graham Gibbs Watson, and
Ernest Dawson Wilkinson

to be a Commission to receive, inquire into, and report upon the matters hereinafter set forth with a view to fostering a greater degree of stability in prices, maintaining full employment of labour, ensuring the healthy development of natural resources, and promoting generally the economic, financial, and social welfare of the people of New Zealand, that is to say, to receive, inquire into, and report upon representations regarding:

(a) Any monetary, banking, and credit proposals that may be suggested as suitable for application in New Zealand;

(b) The present monetary, banking, and credit system in New Zealand and the advisability or otherwise of any changes in that system; and

(c) Any associated matters which should be deemed by you to be relevant to the general objects of the inquiry:

And we do hereby appoint you, the said

Arthur Tyndall,

to be Chairman of the said Commission:

And for the better enabling you to carry these presents into effect you are hereby authorised and empowered to make and conduct any inquiry under these presents at such time and place as you deem expedient, with power to adjourn from time to time and place to place as you think fit, and so that these presents shall continue in force, and the inquiry may at any time and place be resumed although not regularly adjourned from time to time or from place to place:

And you are hereby strictly charged and directed that you shall not at any time publish or otherwise disclose save to His Excellency the Governor-General, in pursuance of these presents or by His Excellency's direction, the contents of any report so made or to be made by you, or any evidence or information obtained by you in the exercise of the powers hereby conferred upon you except such evidence or information as is received in the course of a sitting open to the public:

And it is hereby declared that the powers hereby conferred shall be exercisable notwithstanding the absence at any time of any one or any two of the members hereby appointed so long as the Chairman, or a member deputed by the Chairman to act in his stead, and three other members be present and concur in the exercise of such powers:

And we do further ordain that you have liberty to report your proceedings and findings under this Our Commission from time to time if you shall judge it expedient so to do.

And, using all due diligence, you are required to report to His Excellency the Governor-General in writing under your hands and seals not later than the 31st day of August 1955, your findings and opinions on the matters aforesaid, together with such recommendations as you think fit to make in respect thereof:

And, lastly, it is hereby declared that these presents are issued under the authority of the Letters Patent of His late Majesty King George the Fifth dated the 11th day of May 1917, and under the authority of and subject to the provisions of the Commissions of Inquiry Act 1908, and with the advice and consent of the Executive Council of the Dominion of New Zealand.

In witness whereof we have caused this Our Commission to be issued and the Seal of Our Dominion of New Zealand to be hereunto affixed at Wellington, this 16th day of March in the year of Our Lord one thousand nine hundred and fifty-five, and in the fourth year of Our Reign.

Witness Our Trusty and Well-beloved Sir Charles Willoughby Moke Norrie, Knight Grand Cross of Our Most Distinguished Order of Saint Michael and Saint George, Knight Grand Cross of Our Royal Victorian Order, Companion of Our Most Honourable Order of the Bath, Companion of Our Distinguished Service Order, upon whom has been conferred Our Decoration of the Military Cross and Bar, Lieutenant-General on the retired list of Our Army, Governor-General and Commander-in-Chief in and over New Zealand; acting by and with the advice and consent of Our Executive Council.

[L.S.] C. W. M. NORRIE, Governor-General.

By His Excellency's Command—

S. G. HOLLAND,
for the Minister of Finance.

Approved in Council—

T. J. SHERRARD,
Clerk of the Executive Council.

Extension of Time Within Which the Royal Commission to Inquire Into Matters Concerning the Monetary, Banking, and Credit System of New Zealand May Report

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ELIZABETH THE SECOND, by the Grace of God of the United Kingdom, New Zealand and Her Other Realms and Territories Queen, Head of the Commonwealth, Defender of the Faith:

To Our Trusty and Well-beloved the HONOURABLE MR JUSTICE ARTHUR TYNDALL, C.M.G., of Wellington, Judge of the Court of Arbitration; WILLIAM GORDON VICTOR FERNIE, of Christchurch, Company Manager; RONALD MACGREGOR HUTTON-POTTS, of Invercargill, Managing Editor; CLEMENT GEORGE TROTTER, of Hawera, Managing Director; GORDON GRAHAM GIBBS WATSON, of Wellington, Barrister; and ERNEST DAWSON WILKINSON, of Auckland, Public Accountant: GREETING:

WHEREAS by Our Warrant dated the 16th day of March 1955, issued under the authority of the Letters Patent of His late Majesty King George the Fifth dated the 11th day of May 1917, and under the authority of and subject to the provisions of the Commissions of Inquiry Act 1908, and with the advice and consent of the Executive Council of the Dominion of New Zealand, you were appointed to be a Commission to inquire into and report upon the matters in Our said Warrant set out being matters concerning the Monetary, Banking, and Credit System of New Zealand:

And whereas by Our said Warrant you were required to report to His Excellency the Governor-General not later than the 31st day of August 1955 your findings and opinions on the matters aforesaid, together with such recommendations as you might think fit to make in respect thereof:

And whereas it is expedient that the time for so reporting should be extended as hereinafter provided:

Now, therefore, we do hereby extend until the 30th day of November 1955 the time within which you are so required to report without prejudice to the continuation of the liberty conferred upon you by Our said Warrant to report your proceedings and findings from time to time if you should judge it expedient so to do.

And we do hereby confirm Our said Warrant and the Commission thereby constituted save as modified by these presents:

And it is hereby declared that these presents are issued under the authority of the said Letters Patent of His late Majesty and under the authority of and subject to the Commissions of Inquiry Act 1908 and with the advice and consent of the Executive Council of the Dominion of New Zealand.

In witness whereof we have caused these presents to be issued and the Seal of Our Dominion of New Zealand to be hereunto affixed at Wellington this 17th day of August in the year of Our Lord one thousand nine hundred and fifty-five, and the fourth year of Our Reign.

Witness Our Trusty and Well-beloved Sir Charles Willoughby Moke Norrie, Knight Grand Cross of Our Most Distinguished Order of Saint Michael and Saint George, Knight Grand Cross of Our Royal Victorian Order, Companion of Our Most Honourable Order of the

Bath, Companion of Our Distinguished Service Order, upon whom has been conferred Our Decoration of the Military Cross and Bar, Lieutenant-General on the retired list of Our Army, Governor-General and Commander-in-Chief in and over New Zealand; acting by and with the advice and consent of Our Executive Council.

[L.S.] C. W. M. NORRIE, Governor-General.

By His Excellency's Command—

JACK T. WATTS,
Minister of Finance.

Approved in Council—

T. J. SHERRARD,
Clerk of the Executive Council.

Second Extension of Time Within Which the Royal Commission to Inquire Into Matters Concerning the Monetary, Banking, and Credit System of New Zealand May Report

ELIZABETH THE SECOND, by the Grace of God of the United Kingdom, New Zealand and Her Other Realms and Territories Queen, Head of the Commonwealth, Defender of the Faith:

To Our Trusty and Well-beloved the HONOURABLE MR JUSTICE ARTHUR TYNDALL, C.M.G., of Wellington, Judge of the Court of Arbitration; WILLIAM GORDON VICTOR FERNIE, of Christchurch, Company Manager; RONALD MACGREGOR HUTTON-POTTS, of Invercargill, Managing Editor; CLEMENT GEORGE TROTTER, of Hawera, Managing Director; GORDON GRAHAM GIBBS WATSON, of Wellington, Barrister; and ERNEST DAWSON WILKINSON, of Auckland, Public Accountant: GREETING:

WHEREAS by Our Warrant dated the 16th day of March 1955, issued under the authority of the Letters Patent of His late Majesty King George the Fifth dated the 11th day of May 1917, and under the authority of and subject to the provisions of the Commissions of Inquiry Act 1908, and with the advice and consent of the Executive Council of the Dominion of New Zealand, you were appointed to be a Commission to inquire into and report upon the matters in Our said Warrant set out being matters concerning the Monetary, Banking, and Credit System of New Zealand:

And whereas by Our said Warrant you were required to report to His Excellency the Governor-General not later than the 31st day of August 1955 your findings and opinions on the matters aforesaid, together with such recommendations as you might think fit to make in respect thereof:

And whereas by Our Warrant issued on the 17th day of August 1955 we did extend until the 30th day of November 1955 the time within which you were so required to report:

And whereas it is expedient that the time for so reporting should be further extended as hereinafter provided:

Now, therefore, we do hereby extend until the 31st day of January 1956 the time within which you are so required to report without prejudice to the continuation of the liberty conferred upon you by Our said Warrant of the 16th day of March 1955 to report your proceedings and findings from time to time if you should judge it expedient to do so:

And we do hereby confirm Our said Warrant of the 16th day of March 1955 and the Commission thereby constituted save as modified by Our said Warrant of the 17th day of August 1955 and by these presents:

And it is hereby declared that these presents are issued under the authority of the said Letters Patent of His late Majesty and under the authority of and subject to the Commissions of Inquiry Act 1908 and with the advice and consent of the Executive Council of the Dominion of New Zealand.

In witness whereof we have caused these presents to be issued and the Seal of Our Dominion of New Zealand to be hereunto affixed at Wellington this 22nd day of November in the year of Our Lord one thousand nine hundred and fifty-five, and the fourth year of Our Reign.

Witness Our Trusty and Well-beloved Sir Charles Willoughby Moke Norrie, Knight Grand Cross of Our Most Distinguished Order of Saint Michael and Saint George, Knight Grand Cross of Our Royal Victorian Order, Companion of Our Most Honourable Order of the Bath, Companion of Our Distinguished Service Order, upon whom has been conferred Our Decoration of the Military Cross and Bar, Lieutenant-General on the retired list of Our Army, Governor-General and Commander-in-Chief in and over New Zealand; acting by and with the advice and consent of Our Executive Council.

[L.S.] C. W. M. NORRIE, Governor-General.

By His Excellency's Command—

JACK T. WATTS,
Minister of Finance.

Approved in Council—

T. J. SHERRARD,
Clerk of the Executive Council.

Third Extension of Time Within Which the Royal Commission to Inquire Into Matters Concerning the Monetary, Banking, and Credit System of New Zealand May Report

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ELIZABETH THE SECOND, by the Grace of God of the United Kingdom, New Zealand and Her Other Realms and Territories Queen, Head of the Commonwealth, Defender of the Faith:

To Our Trusty and Well-beloved the HONOURABLE SIR ARTHUR TYNDALL, C.M.G., of Wellington, Judge of the Court of Arbitration; WILLIAM GORDON VICTOR FERNIE, of Christchurch, Company Manager; RONALD MACGREGOR HUTTON-POTTS, of Invercargill, Managing Editor; CLEMENT GEORGE TROTTER, of Hawera, Managing Director; GORDON GRAHAM GIBBS WATSON, of Wellington, Barrister; and ERNEST DAWSON WILKINSON, of Auckland, Public Accountant: GREETING:

WHEREAS by Our Warrant dated the 16th day of March 1955, issued under the authority of the Letters Patent of His late Majesty King George the Fifth dated the 11th day of May 1917, and under the authority of and subject to the provisions of the Commissions of Inquiry Act 1908, and with the advice and consent of the Executive Council of New Zealand, you were appointed to be a Commission to inquire into and report upon the matters in Our said Warrant set out being matters concerning the Monetary, Banking, and Credit System of New Zealand:

And whereas by Our said Warrant you were required to report to His Excellency the Governor-General not later than the 31st day of August 1955 your findings and opinions on the matters aforesaid, together with such recommendations as you might think fit to make in respect thereof:

And whereas by Our Warrant issued on the 17th day of August 1955 we did extend until the 30th day of November 1955 the time within which you were so required to report:

And whereas by Our Warrant issued on the 22nd day of November 1955 we did further extend until the 31st day of January 1956 the time within which you were so required to report:

And whereas it is expedient that the time for so reporting should be again extended as hereinafter provided:

Now, therefore, we do hereby extend until the 31st day of March 1956 the time within which you are so required to report without prejudice to the continuation of the liberty conferred upon you by Our said Warrant of the 16th day of March 1955 to report your proceedings and findings from time to time if you should judge it expedient to do so:

And we do hereby confirm Our said Warrant of the 16th day of March 1955 and the Commission thereby constituted save as modified by Our said Warrants of the 17th day of August 1955 and 22nd day of November 1955 and by these presents:

And it is hereby declared that these presents are issued under the authority of the said Letters Patent of His late Majesty and under the authority of and subject to the Commissions of Inquiry Act 1908 and with the advice and consent of the Executive Council of New Zealand.

In witness whereof we have caused these presents to be issued and the Seal of New Zealand to be hereunto affixed at Wellington this 9th day of January in the year of Our Lord one thousand nine hundred and fifty-six, and the fourth year of Our Reign.

Witness Our Trusty and Well-beloved Sir Charles Willoughby Moke Norrie, Knight Grand Cross of Our Most Distinguished Order of Saint Michael and Saint George, Knight Grand Cross of Our Royal Victorian Order, Companion of Our Most Honourable Order of the Bath, Companion of Our Distinguished Service Order, upon whom has been conferred Our Decoration of the Military Cross and Bar, Lieutenant-General on the retired list of Our Army, Governor-General and Commander-in-Chief in and over New Zealand; acting by and with the advice and consent of Our Executive Council.

[L.S.] C. W. M. NORRIE, Governor-General.

By His Excellency's Command—

JACK T. WATTS,
Minister of Finance.

Approved in Council—

T. J. SHERRARD,
Clerk of the Executive Council.

ROYAL COMMISSION OF INQUIRY INTO MONETARY, BANKING, AND CREDIT SYSTEMS

To His Excellency Sir Charles Willoughby Moke Norrie, Knight Grand Cross of Our Most Distinguished Order of Saint Michael and Saint George, Knight Grand Cross of Our Royal Victorian Order, Companion of Our Most Honourable Order of the Bath, Companion of Our Distinguished Service Order, upon whom has been conferred Our Decoration of the Military Cross and Bar, Lieutenant-General on the retired list of Our Army, Governor-General and Commander-in-Chief in and over New Zealand.

May it Please Your Excellency,—

We, the undersigned Commissioners appointed by Warrant dated 16 March 1955, have the honour to present to Your Excellency our report under the terms of reference stated in that Warrant. We were originally required to present our report by 31 August 1955, but this date was extended by later Warrants to 31 March 1956.

We have the honour to be,

Your Excellency's most obedient servants,

A. Tyndall, Chairman.
William G. V. Fernie, Member.
R. M. Hutton-Potts, Member.
C. G. Trotter, Member.
G. G. G. Watson, Member.
E. D. Wilkinson, Member.

Dated at Wellington this 28th day of March 1956.

Note—Mr G. G. G. Watson was not present when this report was signed. Before he departed from New Zealand on 17 February 1956 he requested that the following statement made by him should be appended to the report:

"I have read carefully all papers for this report and discussed them with my colleagues. We have agreed in principle on all matters of importance and accordingly I have authorised the Chairman on my behalf to sign my name to the final document."

Pursuant to the foregoing authority the report has been signed by the Chairman on behalf of Mr Watson.

REPORT

Section One

PREFACE

1. At an initial meeting held in Wellington on 31 March 1955 the Commission decided that a general invitation should be extended to all interested persons or organisations to place their views or proposals before the Commission. It was also decided that interested persons or organisations should be given the opportunity of appearing personally or of being represented at public hearings conducted by the Commission if they so desired. Suitably worded advertisements were accordingly inserted in all daily newspapers, and copies of the advertisement were sent by letter to all organisations considered to be interested in making submissions.

2. As a first step in the public inquiry the Commission invited the Reserve Bank, the Treasury, and the Associated Banks in New Zealand (the trading banks' organisation) to prepare and submit statements covering the present monetary, banking, and credit systems. Subsequently, similar invitations were extended to other organisations dealing or connected with particular portions of the present systems.

3. In Appendix A we list the seventy-two witnesses and the counsel who appeared at the public hearings. Thirteen of the witnesses appeared in response to direct invitations from the Commission. The other fifty-nine witnesses volunteered personal submissions or presented the views of organisations which desired to make submissions.

4. In view of the specific wording of its terms of reference, the Commission considered that its primary duty was to report upon *representations received* regarding any monetary, banking, and credit proposals. After broad outlines of the present system had been presented by the respective institutions concerned, early steps were taken to hear such representations in public, and accordingly the hearing of a number of invited statements covering many aspects of the existing system was delayed till a later stage in the proceedings.

Procedure

5. Public hearings began on 28 April 1955 with a statement by the Commission on the procedure it intended to adopt. The more important sections of the statement read:

> The Commission does not propose to recognise any parties to the inquiry, as no person or institution is on trial or in jeopardy.
>
> The Commission is not being supplied with any form of legal assistance, but expert personnel is attached to the Commission to help it in elucidating the various matters falling within the scope of the order of reference.
>
> Persons appearing before the Commission will be expected to read any written submission.
>
> Any person wishing to cross-examine a witness before the Commission should apply to the Commission for permission to do so, and at the same time should give the grounds for or the purpose of his application.

As a general guiding principle the Commission, in the light of the foregoing statements and having regard to the shortness of the period available for its work, proposes to limit the right of cross-examination as far as possible to the following cases:

(a) Where the person applying or an institution which he represents has been attacked or criticised by a witness; and

(b) Where statements made during the course of the proceedings by or on behalf of the person applying have been challenged in any way by the witness or the person calling him.

Any witness who is being cross-examined will be permitted if he so desires to take time to give a considered answer to any questions at a later stage of the public hearings.

Persons appearing as advocates and calling witnesses in support of their submissions will not be subject to cross-examination, which will be reserved for the witnesses they call.

Advocates who do not propose to call witnesses and who do not themselves take the witness stand will be in the position of having no evidence to support their submissions.

Rights of Cross-examination

6. At the opening of the public hearings it was suggested by certain advocates and counsel that the rights of cross-examination were too restrictive, and that the Commission did not possess sufficient powers to enable the inquiry to be as thorough as was desirable. So far as the rights of cross-examination are concerned, the Commission has formed the opinion that the procedure adopted provided every reasonable facility for interested persons and organisations to examine witnesses. As an indication of the extent to which witnesses were cross-examined, it is pointed out that approximately one-quarter of the total time taken up by public hearings was devoted to such cross-examination.

Power to Require the Production of Information

7. The second point raised before the Commission at its first public sitting concerned the powers of the Commission to require the production of certain information. Reference was made to section 21 of the Banking Act 1908, which provides that, on the application of any party to a legal proceeding, a Court or Judge may order that such party be at liberty to inspect and take copies of any entries in the books of a bank for any of the purposes of such proceeding. Some persons who initially appeared before the Commission therefore sought to be joined as "parties" to the proceedings, and indicated their intention to apply for orders under section 21 of the Banking Act. At the same time it was submitted that the Commission did not possess adequate powers to make such orders in that the Chairman of the Commission was not a Judge of the Supreme Court and consequently could not exercise the powers vested in a Judge of that Court by section 21 of the Banking Act and by section 13 of the Commissions of Inquiry Act 1908. Certain suggestions were made under which it was contended the powers of the Commission should be extended.

8. After immediate consideration of these issues, the Commission asserted that it proposed to give all reasonable opportunity, within the scope of the terms of reference, to all persons appearing before it; that it adhered to its decision not to recognise parties to the inquiry; and that if any lack of necessary powers to perform its functions became apparent it would consider the situation further and would take any steps necessary to enable it adequately to fulfil its purpose.

9. Reference was made at various stages of the public proceedings to this alleged lack of powers, but the Commission wishes it to be placed clearly on record that at no stage of its hearings or subsequent deliberations has the situation arisen where any additional powers have proved to be necessary to obtain essential information. A number of confidential questions was directed by the Commission to the trading banks, and these were always answered promptly in written form and as frankly as the Commission could wish. Viewing the situation since the conclusion of our hearings, we are satisfied that all information that could reasonably be sought was obtained by the Commission. Further, we are satisfied that the persons appearing before the Commission had adequate opportunity of eliciting all the information that could be regarded as reasonably necessary for the proper presentation of their views. Indeed, we are strongly of the opinion that the procedure adopted by the Commission under which representatives of the Reserve Bank, the Associated Banks, and the Treasury initially presented informative statements at the public hearings and submitted to cross-examination was of great value and assistance to all who followed.

Confidential Nature of Advice Given to Government

10. During the course of the proceedings a further important point arose concerning communications between the Reserve Bank, the Government, and the Treasury, and concerning advice given by the Reserve Bank to the Government. The Governor of the Reserve Bank declined to answer questions relating to those matters, on the grounds that the Reserve Bank was banker for the Government and the Treasury, and that it would be a breach of confidence on his part to disclose communications that might have passed between bank and customer over a period of years. The Commission was asked to give a direction that the witness should answer such questions.

11. In its decision on this point the Commission held that the objection to a possible breach of confidence between banker and customer was a perfectly proper objection for the Governor of the Reserve Bank to raise, but that the point did not need to be decided on that ground alone. The Commission was concerned with the monetary, banking, and credit systems, and it had emerged in evidence that, under the existing systems, consultations and discussions took place before decisions were made. The decisions themselves were important, but the Commission was not concerned with the details of the discussions which may have led to those decisions.

12. In the Commission's view it would have been most improper that details of advice tendered to the Government by persons holding responsible positions such as Governor of the Reserve Bank and Secretary to the Treasury should be disclosed and discussed in public when the knowledge of the details would not assist the Commission in the performance of its functions.

Details of Public Hearings

13. As previously noted, the public hearings began on 28 April 1955, and continued until 30 September 1955, with short adjournments from time to time. Eighty-seven sitting days were involved. The transcript of proceedings covered 4,926 single-space foolscap sheets of typing. With the

written submissions included, this made a total of nearly 7,000 sheets, containing some 2,250,000 words. Most of the hearings were held in Wellington, but the Commission also travelled to Auckland for a sitting of nine days, and to Christchurch for a sitting of two days. Reasonably adequate opportunity to appear before the Commission was afforded to all persons who desired to do so. Special procedures were adopted in a number of cases to shorten the time of the public hearings, e.g., by taking as read certain documents which had been submitted in advance.

Written Submissions

14. In addition to the representations and proposals of the many witnesses who appeared in person, the Commission received and considered eighty-nine written submissions where no appearance was sought. Appendix B to this report contains the names of the persons who made such submissions, together with a brief note of the major proposals made.

General

15. The great variety of subjects covered in the submissions reflects the wide scope of the terms of reference. The Commission found that some of the representations made were clearly irrelevant but, as it adopted a liberal interpretation of the terms of reference and as practically every witness readily co-operated, very little difficulty was experienced in this aspect of the Commission's work.

16. In this report we use statistics, where available, up to 31 December 1955. It will be noticed that yearly figures quoted are sometimes those of calendar years, sometimes of financial years, and sometimes are taken to another point in each year. Further, when comparisons are made between years the base period selected is not always the same. In each instance we have selected the time of termination of each year's figure, and the basic period for comparisons, which are most appropriate to the study then being undertaken. In this way it is possible to avoid complications such as occur, for example, through seasonal movements in trade or finance. In some instances the statistics we would have liked to use were not available, and, in some tables, rounding off results in totals disagreeing slightly with the total of individual items shown in the tables.

17. Our comments, criticisms, findings, and recommendations are based on the evidence and submissions made to us and on our knowledge of events up to 31 December 1955. Where matters arising since that date are relevant to any section of our report, they are recorded by way of a note inserted at the appropriate point.

18. Short quotations taken from statements, submissions, and examination of witnesses are set in the text in italics within quotation marks. Lengthy quotations are set in smaller type in block form. We consider it very desirable in these instances to quote the actual words used so that no question of misquotation can arise.

Staff Assistance

19. We wish to record our deep appreciation of the services rendered by the staff attached to the Commission. In particular we would warmly commend the great assistance given by Messrs A. McGregor and F. W. Holmes, whose services were made available to the Commission

in a technical capacity. We would also specially mention our indebtedness to the Secretary, Mr J. C. Redward. Both he and the reporting and administrative staff under his control performed their arduous and exacting duties in an exemplary manner and thereby facilitated the work of the Commission.

Form of This Report

20. In this report we adopt the following general approach to our consideration of the submissions received:

(a) Examination of the economic objectives as outlined in our terms of reference.
(b) A general economic review of the period 1934 to 1955.
(c) An analysis of the nature of "money" and a review of the monetary, banking, and credit systems from 1934 to 1955.
(d) A discussion of the causes of the inflation which has been experienced over recent years.
(e) Consideration of the Welfare State and its effects on the economy.
(f) General comments on the present monetary, banking, and credit systems.
(g) An examination of the question of State monopoly of credit creation.
(h) Reviews of the submissions made by Social Credit advocates, by Mr H. J. Kelliher and the Mirror Publishing Co. Ltd., and by Mr Colin Clark.
(i) Views on reform of the present systems, and comments on proposals made for reform.
(j) To keep the main body of the report within reasonable compass, a number of subjects have been dealt with in greater detail in appendices.
(k) Statistical tables appear in Appendix H.

Section Two

OBJECTIVES OF ECONOMIC POLICY

21. Before discussing the general objectives of economic policy laid down in our terms of reference it is necessary to mention some of the basic geographical and other conditions which govern very broadly the lines of economic development in this country.

22. New Zealand is geographically isolated from the main centres of world population, yet her economy is closely interdependent with that of the United Kingdom and with the other countries which buy her exports and supply her imports.

23. Apart from coal and lime, New Zealand's known mineral resources are meagre. It follows that her manufacturing and processing industries are heavily dependent on imported raw materials, except where they are based upon agricultural and pastoral production, or upon forests.

24. New Zealand is very largely dependent on overseas markets for the sale of her wool, dairy produce, meat, forest products, and other exports. She is also dependent on overseas countries for a wide range of imports, including consumer goods, industrial and other machinery, phosphatic fertilisers, industrial raw materials, and motor spirits and oils. More than a quarter of all goods and services used in New Zealand is imported.

25. Of New Zealand's area of 66 million acres, only 20 million acres can be described as "improved" land. About 2 million acres consist of field crops, gardens, orchards, and plantations. The other 18 million acres of improved land are in sown pasture. Of this 18 million acres about 6½ million acres of flat or low contour country have been cultivated and ploughed before sowing pasture. It is from this area, representing only 10 per cent of the total land in New Zealand, that by far the greatest part of farm production is derived. The natural fertility of most of this land is relatively low. Its very high productivity is the result of skilful farming and of scientific land use including the extensive application of fertilisers.

26. New Zealand's economy is thus to a major extent based upon agriculture and especially upon grasslands farming. It has been said that her most important resource is her climate, which includes an ample rainfall well distributed throughout the year.

27. New Zealand's total population, at present 2,165,000, has shown a rapid rate of increase in recent years. Of her total labour force (about 802,000) only 152,000 are engaged in farming and other primary industry. Over 90 per cent of the population is of British descent. Between 6 and 7 per cent is Maori.

28. The form of government is parliamentary with only one chamber, the House of Representatives. The Government has full sovereignty and there is no written constitution. General elections are normally held at intervals of three years.

29. The basic facts of geographical isolation, favourable conditions for agriculture, dependence on overseas trade, relative smallness of population and internal market, and the institutions of parliamentary government, comprise the broad framework within which the objectives of our economic policy must be pursued.

Objectives Set Out in Commission's Terms of Reference

30. Under its terms of reference the Commission was required to have regard to these general objectives in the course of its inquiry:

(a) The fostering of a greater degree of stability in prices.
(b) The maintaining of full employment of labour.
(c) The ensuring of the healthy development of natural resources.
(d) The promoting generally of the economic, financial, and social welfare of the people of New Zealand.

31. Our terms of reference do not refer to stability in prices in the absolute sense, but to a greater degree of stability in prices. In a country such as New Zealand, the level of prices is affected to a major degree by changes in prices overseas. Policies designed to secure a greater measure of stability in New Zealand should therefore be directed towards correcting price instability arising from causes in New Zealand, and towards limiting the effects in New Zealand of price changes occurring outside New Zealand.

32. "Maintaining full employment of labour" is not an expression capable of precise interpretation. There is no generally accepted definition of full employment. The term does not mean that no one should ever be out of employment, because in any progressive industrial economy there will always be a number of workers in the process of changing from one employment to another. A reasonable approach to this objective would be to aim at a state of affairs where the interval between leaving one job and beginning in another need not be prolonged, and where the number of employment vacancies approximates the number of persons seeking employment.

33. "Ensuring the healthy development of natural resources" includes encouragement of farm production and utilisation of forest, mineral, and other natural resources. Because of the importance to New Zealand of her export trade, this objective must also include keeping production costs in our export industries at least competitive with those in other primary producing countries. A necessary corollary of this objective is the promotion of manufacturing and other secondary industries on an economic basis and the provision of adequate power, transport, and other services.

34. "Promoting generally the economic, financial, and social welfare of the people of New Zealand" is a very wide purpose. We interpret it as including the objectives of increased productivity leading to higher living standards, the promotion of overseas trade (including the maintenance of adequate reserves of overseas exchange to cushion the effects of fluctuations in overseas earnings), and the fostering of arrangements designed to facilitate international trade and to remove trade barriers. Broad social objectives also fall under this heading – the equitable distribution of the national income and the relief of the individual from some of the financial burdens of family responsibility, sickness, old age, and unemployment.

Conflicts Between Objectives

35. A policy designed to further any one of these ends may at the same time adversely affect some of the other objectives. For example, overemphasis on full employment of labour may cause inflation and so frustrate the achievement of greater stability in prices. Similarly, conflict may arise between the objectives of developing natural resources and of maintaining adequate reserves of overseas funds. A further conflict may arise between the desire for higher living standards immediately and the need to divert resources to capital expenditure and so build up productive capacity in the future.

36. It follows that, in considering its economic, monetary, and fiscal policies, the Government must from time to time balance the favourable effects of any proposal on one objective against its unfavourable effects on one or more of the other objectives.

37. The manner in which the objectives of price stability, full employment, economic development, productivity, external trade, and social welfare have been given different emphasis in the changing conditions of war and peace is shown in the next Section which traces the main trend of economic events in New Zealand over the last twenty-one years.

Section Three

ECONOMIC REVIEW, 1934 TO 1955

38. It is about twenty-one years since the last general inquiry into monetary and banking systems in New Zealand. The report of the 1934 Parliamentary Committee reviews events prior to 1934 and the operation of the banking system before that time. In 1934 the Reserve Bank of New Zealand, established by the Reserve Bank of New Zealand Act 1933, began business and the New Zealand banking system took its present general form. It seems appropriate, therefore, to confine this review to the period since 1934.

39. During this period Governments have accepted in varying degrees and in different ways much wider responsibility for management of the whole economy in the national interest. In New Zealand the establishment of the Reserve Bank as part of this development gave the Government the means to co-ordinate monetary policy with its own fiscal policies. A notable change reflecting the acceptance of this wider responsibility in New Zealand was the establishment of the social security scheme, with its provisions designed to assist the discharge of family responsibilities and to give protection against vicissitudes of unemployment, prolonged illness, and old age. Other legislation made provision for a guaranteed price for the dairy industry and the forty-hour week.

40. This new responsibility has had to be discharged in circumstances of particular difficulty. Like other countries, New Zealand had to take the strain of a major war just as her economy had emerged from a depression and had then to face the problems of post-war readjustment. And New Zealand has also her own special problems. Because she is highly dependent on overseas trade her economy is very susceptible to influences beyond her own control. Over the last twenty-one years rising prices in overseas markets have been reflected in buoyant incomes in New Zealand and in a rising internal price level. As a young country New Zealand has to face the problem of two conflicting demands on her resources of labour, materials, and overseas exchange; that is, the demand created by her standard of living, and the demand for capital development to meet the needs of a growing population and an expanding economy.

41. Problems such as arise from the fall in the purchasing power of the New Zealand pound, from the impossibility of meeting all demands for imports, and from the shortage of labour in New Zealand, should all be examined in the light of the circumstances of the last twenty-one years.

42. The general outline of economic events for the greater part of that period has been set out in *The New Zealand Economy 1939 to 1951*, the first of the official Economic Surveys, and in the subsequent annual

surveys. There is therefore no need for a detailed account of economic events since 1934. Those events and changes have been selected which seem useful in making clear the broad economic background against which our monetary, banking, and credit systems have operated and developed. And an assessment has been made of the main economic forces operating in the last twenty-one years with an analysis of the measures taken to control and influence the economy during that period. The development of the monetary, banking, and credit systems since 1934 is dealt with in Section Four of this report.

43. In this review the period since 1934 is treated in four main sections:

(a) 1934–35 to 1938–39: Recovery from depression.
(b) 1939–40 to 1945–46: World War II.
(c) 1946–47 to 1948–49: Post-war reconstruction and recovery.
(d) 1949–50 to 1954–55: The recent period of accelerated population increase and higher capital investment.

1934–35 to 1938–39: Recovery from Depression

44. Already in 1934 there had been some recovery from depression. Unemployment had fallen considerably. Meat and wool prices had improved. The index of export prices on a New Zealand currency basis had risen by 12 per cent compared with 1931, and the index of value in New Zealand currency of total exports had risen by 35 per cent. Between 1931 and 1934 the index of volume of exports rose by 25 per cent. New Zealand's recovery between 1931 and 1934 was therefore aided by substantially increased production for export as well as by higher prices for exports. In 1933–34, value of factory production rose by 8·6 per cent and in the following year it increased by a further 10·5 per cent. Recovery was also aided by Government expenditure on public works, on employment subsidies, and on housing and social services, including unemployment benefits.

45. The next few years saw further gradual recovery, due chiefly to rising overseas prices for New Zealand exports, and to the continuation and expansion of the deliberate policy of increased Government spending and increased lending by the State Advances Corporation.

46. The following figures of gross capital investment (excluding changes in value of stocks) point to the degree of recovery by 1939.

Year Ended March	Private	Government	Total	Percentage of Gross National Income
	£ million	£ million	£ million	
1933	4	6	10	9
1939	17	22	39	17

47. Between 1933–34 and 1938–39 the volume of factory production rose by 69 per cent. In 1938–39 unemployment had been greatly reduced although some 24,000 men were in subsidised full-time employment. (Earnings of overseas exchange rose from £49 million in 1933–34 to £69 million in 1937–38, then fell to £63 million in 1938–39.)

48. In 1936 the Government took full control of the Reserve Bank. In this way it acquired, as the then Minister of Finance later explained, *"full control of banking and currency within the Dominion"*. In the same year the forty-hour week was introduced. In 1937 the Government introduced the guaranteed price scheme for dairy produce, and in 1939 the social security scheme began to operate.

49. Most of the increasing Government spending in the four years up to 1938–39 was financed by taxation and by borrowing from the public. But in 1938–39 the Government was unable to obtain enough money from non-banking sources to finance its expenditure, including its expanding works programme, and therefore its net indebtedness to the banking system rose by nearly £18 million.

50. The following extract from the 1939 Budget shows that, although expanded Government expenditure (partly financed from bank credit) assisted in overcoming unemployment, it also led to balance of payments difficulties: *"Action along the lines indicated produced quick results, but in the absence of an equally rapid expansion in production it led to an increase in imports and a drain upon the sterling resources of the Dominion"*.

51. In the calendar year 1938 the net overseas assets of the banking system fell from £23 million to £7½ million. Among causes of this serious deterioration in the country's reserves of overseas funds were a fall in export income accompanied by higher demand for imports, Government borrowing from the banking system, and substantial capital remittances from New Zealand.

52. To meet this balance of payments crisis comprehensive import and exchange controls were introduced in December 1938.

1939–40 to 1945–46: World War II

53. The import and exchange controls introduced in 1938 stopped the drain on overseas funds by restricting the supply of imports. But since there was no corresponding reduction in purchasing power in New Zealand it also accentuated the internal inflationary pressures. From this and other causes, including the enlarged Government spending, there now existed a greater demand than could be met for locally produced and imported goods and services. The war brought a diversion of labour, materials, and industrial capacity from production of consumer goods and services in New Zealand to war production. A similar diversion of resources dried up the supply of imports from the United Kingdom and other countries. Yet, at the same time, incomes in New Zealand were maintained and increased through spending on war production. The result of all these factors was to build up inflationary pressures still further. An excess of overseas receipts over payments of £28 million for the calendar year 1944 and of £43 million for 1945 generated strong inflationary pressures in those years.

54. The national income statistics illustrate the diversion of resources to war purposes between 1939 and 1945. Personal consumption fell from 70 per cent of gross national income in 1938–39 to 47 per cent in 1943–44. Current Government expenditure on goods and services in that period increased from 13 to 43 per cent, including an increase from 1 to 35 per cent for war purposes.

55. Wartime budgets were designed to absorb as much as possible of the surplus purchasing power, a policy described in one Budget as *"to tax to the economic limit for war purposes and borrow for essential production works and for any balance of war requirements"*. The objective was to finance at least half of the cost of the war from taxation. This objective was more than achieved with total taxation for war purposes at £263 million (including £38 million transferred from the Consolidated Fund to the War Expenses Account) and net borrowing for war purposes £239 million. A remarkable and commendable feature of New Zealand war finance was the relatively minor use of bank credit by the Government. Between August 1939 and August 1945 net Government indebtedness to the banking system rose by only £23 million or about 3 per cent of the total Government expenditure for war purposes.

56. The lend-lease scheme considerably eased some of the problems associated with war finance. New Zealand received goods and services valued at £112 million as reciprocal aid and provided to the United States and Canadian authorities assistance valued at £82 million. If New Zealand had been required to pay in overseas funds for lend-lease assistance from the United States and Canada, the position of her external reserves, which rose from £10 million to £87 million at the end of the war, would at that time have been much less favourable.

57. Price control and other measures introduced up to the end of 1941 proved ineffective in preventing price increases. A more extensive stabilisation scheme, including additional price controls, control of maximum salaries and wages, and price subsidies, was therefore introduced in 1942. In the same year Government control of industrial manpower commenced. Stabilisation was considerably assisted by international schemes for controlling raw material prices and supplies and by the co-operation of all sections of the community.

58. Early in the war the Government adopted the policy of compulsory bulk purchase of the main exports which were sold to the United Kingdom on a Government to Government basis. From 1943, payments to primary industry stabilisation accounts ensured that increased export incomes received under those agreements were not spent by the farmers, but were set aside for later use for the benefit of the industries. These industry accounts became an important source of Government borrowing during the war and post-war years.

59. Apart from the effects of the stabilisation scheme and of fiscal policies, an important contribution to stability in the war years was the high level of private savings. Small savings, including savings in the Post Office and trustee savings banks, and national savings accounts and bonds, increased by £92 million during the war.

60. Between 1939 and 1945 the retail prices index rose from 990 to 1170 (1926–30 = 1000), i.e., by approximately 18 per cent or about 3 per cent per annum. This was a relatively small increase compared with the rise of 35 per cent, or an average of about 9 per cent per annum, in New Zealand retail prices during the 1914–18 war. During World War II retail prices rose by 28 per cent in the United Kingdom, 29 per cent in the United States, and 22 per cent in Australia compared with the 18 per cent in New Zealand.

1946–47 to 1948–49: Post-war Reconstruction and Recovery

61. The years immediately following the war brought their own difficulties. Labour, materials, and industrial capacity had to be devoted in large part to capital works such as hydro-electric schemes and housing which it had been impossible to undertake in wartime conditions. As a result, sufficient goods and services for everyday use could still not be provided to match the available spending power which included substantial accumulations of wartime savings.

62. The increasing diversion of resources to meet the need for capital works is shown by the fact that the total of Government and private capital investment programmes rose between 1946 and 1949 from £49 million to £87 million. The percentage of gross national income absorbed by capital works increased from 12 per cent in 1946 to 18 per cent in 1949. In 1933 the corresponding figure was 9 per cent and in 1938 it was 15 per cent. In 1943 diversion of resources to war purposes and shortages of imports of capital goods had reduced the percentage of gross capital investment to 5 per cent.

63. Some man-power controls were released in 1945, and those remaining were lifted in June 1946. Most of the wartime direct controls remained until 1947, and held in check the tendency to increasing prices and to a high demand for imports, so that monetary policy played only a minor part in management of the economy. Selective control of bank advances channelled some investment according to Government policy. Increases in the farm industry stabilisation accounts continued to provide an important source for Government borrowing.

64. In 1946 the family benefit of 10s. per week was made universal. The Government reduced purchasing power in the hands of the public and restrained inflationary pressures by taxation and borrowing in New Zealand to repay overseas loans. For example, during the three years ended March 1948, the Government in this way financed repayment of £62 million in New Zealand currency. The repayments in London had to be made in United Kingdom currency (£50 million), which came from the accumulated overseas funds held by the Reserve Bank.

65. However, in 1948–49 this substantial reduction in overseas indebtedness was followed by an increase of £18 million in Government indebtedness to the banking system in New Zealand. This arose because in 1948–49 overseas transactions showed a deficit, trading-bank advances decreased slightly, small savings fell, and the money market became tight. The Government was then unable to attract sufficient savings to finance its capital works programme.

66. The extent to which the New Zealand price level was held down during the war and early post-war periods by the stabilisation scheme and other measures is illustrated by the fact that, by the middle of 1948, the cost of imported items in the wholesale prices index had risen by over 90 per cent since 1939, whereas wholesale prices of locally produced items had risen by a little more than 40 per cent and retail prices by about 33 per cent. In 1948 the New Zealand retail prices index stood at 1314 compared with 990 in 1939. During the calendar years 1946 to 1948 retail prices index figures were as follows:

Calendar Year	Index (Base: 1926–30=1000)	Percentage Increase Compared With Previous Year
1946	1180	0·9
1947	1217	3·1
1948	1314	8·0

67. The success of the war and post-war stabilisation programme was an important factor in making possible the appreciation of the New Zealand pound in August 1948. Until then £100 United Kingdom currency had been equivalent to £125 New Zealand currency. Before the appreciation, exporters received £125 in New Zealand currency for each £100 United Kingdom currency from sale of exports and New Zealand importers had to pay £125 in New Zealand currency for imports costing £100 in United Kingdom money. After the appreciation, transactions were conducted approximately at £100 New Zealand currency equals £100 United Kingdom currency.

1949–50 to 1954–55: A Period of Accelerated Population Increase and Higher Capital Investment

68. As the war and post-war stabilisation scheme was gradually dismantled, prices rose. The index of retail prices moved as follows:

Calendar Year	Index (Base: 1926–30=1000)	Percentage Annual Increase Over Previous Year
1949	1336	1·7
1950	1411	5·6
1951	1566	11·0
1952	1688	7·8
1953	1765	4·6
1954	1847	4·6
1955	1892	2·4

69. Before 1948 a variety of direct controls prevented inflationary pressures from having their full effect on prices. In the years following removal of these controls, price increases were more pronounced than they otherwise would have been because the previously suppressed pressures were then allowed to be fully reflected in price increases.

70. The 1948 adjustment of the exchange rate reduced the amount of annual accretions to the primary industry stabilisation accounts. The diminution of this source of borrowing, combined with the decline in saving and other factors already discussed, led to an increase of £15 million in Government indebtedness to the banking system in 1949–50.

71. In 1950–51 the Korean War brought a remarkable increase in demand for international commodities including wool and, as a result, incomes in general in New Zealand increased substantially. But imports

did not immediately rise sufficiently to absorb all this additional purchasing power. To reduce the sudden increase of purchasing power it was agreed between the wool growers and the Government that one-third of the gross realisation, with some minor exceptions, should be frozen in individual accounts of the growers at the trading banks or with stock and station agents. However, although spending by individual growers was curbed by the wool retention scheme, no special steps were taken to restrict the lending capacity of the trading banks by raising the reserve ratio and thus immobilising part of the additional bankers' cash held by them at the Reserve Bank.

72. The extra overseas exchange arising from the high wool prices enabled the Government to dispense with a wide range of import controls, particularly on imports from sterling area countries.

73. The very high wool prices did not last long and the average price of wool fell from 138d. in February 1951 to 38d. in August 1951. But other causes of inflation remained. Export incomes other than for wool rose considerably.

74. Private investment showed a marked increase from £57 million or 11 per cent of the gross national income in 1949–50 to £101 million or 13 per cent of the much higher gross national income in 1952–53 and further increased to £129 million or 14 per cent of the gross national income in 1954–55.

75. After the wool boom in 1950–51 private imports rose from £125·5 million in the year ended June 1950 to £148·3 million in 1951 and £249·4 million in 1952. Between the June years 1950–51 and 1951–52 the balance of external trade and other overseas transactions changed from a surplus of £39 million to a deficit of £51 million, a total change of £90 million. The following table summarises New Zealand's external receipts and payments for the three years ended 30 June 1952:

(£ million)

	Year Ended June		
	1950	1951	1952
RECEIPTS			
Wool	63·4	116·2	96·2
Other exports	104·3	107·1	140·5
Receipts other than for exports	21·1	20·0	28·7
Total receipts	188·9	243·3	265·4
PAYMENTS			
Private imports	125·5	148·3	249·4
Government imports	17·8	21·9	25·0
Other payments	39·3	34·0	42·3
Total payments	182·6	204·2	316·6
Surplus (+) or deficit (−)	+6·3	+39·1	−51·3

76. The very substantial deficit in overseas transactions in 1951–52 led to the exchange allocation scheme, operated by the Reserve Bank from April 1952 until December 1954, but latterly with reducing severity.

77. In 1953–54 the economy showed an easing of the employment situation. Recorded vacancies for employment in industry had fallen from 34,000 in 1950 to 20,000 in April 1953. In 1954, however, the pressure returned. Payments for private imports had averaged £15·7 million per month for the first half of 1954. This figure rose to £20·6 million for the second half of 1954 and was £19·8 million for the first half of 1955. From June 1955 to December 1955 the average monthly rate was £21·2 million. Ruling wage rates and employment vacancies both rose. In 1955, imports and other external payments exceeded overseas earnings (including Government overseas borrowing of £7·3 million) by £26·5 million.

Significant Developments, 1934 to 1955

78. The foregoing is a review in broadest outline of economic trends in the twenty-one years between 1934 and 1955, divided into significant periods. A number of other developments and changes can be more appropriately examined over the whole twenty-one years.

Population

79. For our purposes the most important aspects of population are its annual rate of growth from natural increase and from immigration, and its division into age groups. Between 1934 and 1939 total population rose from 1,552,000 to 1,629,000, an increase of 5 per cent in five years. In the five years to December 1955 the increase was from 1,909,000 to 2,139,000, an increase for the five years of 12 per cent. This change in rate of increase has an economic significance because of the consequent high demand for a wide range of capital works, including housing, schools, transport facilities, and industrial buildings and machinery to meet the needs of a rising population.

80. The annual rate of population increase of over 2 per cent in the five years to December 1955 is a very high rate of population increase compared with population growth in other countries. On page 31 of the 1955 *New Zealand Official Year Book* there is a table showing the average annual percentage increase in population for some twenty-one countries for recent intercensal periods. The average annual percentage increase for New Zealand is greater than for any of the other countries shown in the table except Australia.

81. Two main factors are directly responsible for the rising rate of population increase. The birth rate has shown a rising tendency since 1935, and net migration has become important in the post-war years. The change in the birth rate per 1,000 of European population since 1935 is illustrated by this table:

Calendar Year	Birth Rate Per 1,000 of Mean Population	Calendar Year	Birth Rate Per 1,000 of Mean Population
1935	16·17	1950	24·67
1940	21·19	1954	24·63
1945	23·22	1955	24·85

82. Migration as compared with natural increase has had a relatively small effect on recent population growth in New Zealand, as the following figures show:

Year Ended March	Natural Increase		Migration Increase	
	Number	Percentage of Population	Number	Percentage of Population
1939	15,164	0·93	5,071	0·31
1952	31,731	1·60	15,479	0·78
1953	33,158	1·63	20,334	1·00
1954	34,136	1·64	15,047	0·72
1955	35,380	1·66	7,376	0·35

83. Even in the year ended March 1953, a year of exceptionally high immigration, the increase in population from migration did not reach two-thirds of the natural increase, while in 1954–55 the proportion was about one-fifth. Although migration has a relatively small effect on total increase in population, it makes its own special demand on the economy, because the adult migrant must immediately have somewhere to live, and very often some place to work in and some industrial equipment to use. In this way immigration adds directly to the demand for capital expenditure, and adds temporarily to inflationary pressure.

84. Changes in the age distribution of the population – particularly the proportion of the population in the fifteen to sixty-four age group – have had important economic effects. In 1934 this age group (which is generally taken as an indicator of the potential labour force) comprised 67 per cent of the population, compared with 60 per cent in 1954. The following table shows the changes which have taken place:

Population (Age Group)	Calendar Year, 1934		Calendar Year, 1954	
	Mean Number	Per Cent	Mean Number	Per Cent
	Thousands		Thousands	
0 to 14	419	27	648	31
15 to 64	1,039	67	1,257	60
Over 64	92	6	190	9
	1,550	100	2,095	100

85. The provision of universal and other age benefits becomes a greater burden on the rest of the community as the proportion of the population over sixty-four years of age increases. However, that burden is reduced to some extent if more people continue working after the age of sixty-four, as many now do. The higher birth-rate since 1935 may be expected to result in a higher proportion of population in the fifteen to sixty-four age group in the next few decades.

Labour Force

86. The following table compares the labour force and its estimated distribution in 1939 with the estimate for October 1955:

	1939		1955 (October)	
	Number	Per Cent	Number	Per Cent
	Thousands		Thousands	
Primary industries (mostly farming) ..	179	27	152	19
Secondary industries (mostly manufacturing and building construction)	187	28	278	35
Tertiary industries	284	42	362	45
Armed Forces	3	..	10	1
Unemployed	19	3	..	..
	672	100	802	100

87. The proportion of the labour force employed in farming and related industries has fallen from 27 per cent in 1939 to 19 per cent in 1955, while the percentage employed in secondary industry has risen from 28 to 35. Over the last five years the number employed in primary industries has been virtually stationary at about 150,000.

The National Income

88. The national income is the total of all labour and property income earned in producing the national output of goods and services. It is the total incomes earned by wage and salary earners, plus interest, profits, rents, and royalties. From another viewpoint it is the net value of goods and services produced in a year, valued at the prices ruling in that year.

89. Since 1935 the national income of New Zealand has risen through increases in two important elements, the volume of goods and services produced in New Zealand and the prices of those goods and services.

90. The following table shows the gross national income (1), both at current prices for the respective years and converted to the basis of 1954–55 prices, at five-yearly intervals since 1935:

(£ million)

Year Ended March	Gross National Income (1) at— Current Prices for Respective Years	1954–55 Prices
1935	136	310
1940	248	463
1945	379	606
1950	552	763
1955	927	927

(1) Note.—The gross national income is the national income as defined above, together with depreciation allowances and indirect taxes (minus subsidies).

91. The figures for gross national income at current prices reflect both increases in production and price increases, while in the column headed "1954–55 Prices" a rough attempt has been made to eliminate the effect of price increases by correcting the annual totals for changes in the retail prices index number. Gross national income in 1954–55 at current prices is about seven times what it was in 1934–35. Corrected for price changes in this way the gross national income is three times what it was in 1934–35.

Volume of Production

92. Since 1935 farm production in New Zealand has risen by about one-third. The most pronounced increase has been in the last decade and especially in the last five years. Between 1934 and 1939 volume of factory production rose by two-thirds. Since 1939 the total increase has been 111 per cent and in the last ten years the increase in volume of factory production has been 64 per cent.

93. The following index numbers of volume of total production per head were supplied by the Government Statistician:

Year	Per Head of Population (Converted to Base: 1946–47 = 100 from Base: 1938–39 = 100)	Per Head of Labour Force (Base: 1946–47 = 100)
1946–47	100	100
1947–48	103	102
1948–49	106	107
1949–50	109	110
1950–51	110	113
1951–52	110	113
1952–53	110	114
1953–54(1)	110	115

(1) Provisional

94. In considering the relative stability of the volume of production per head of population between 1949–50 and 1953–54 allowance should be made for the fact that these are years of rapid population increase and of a high birth rate.

95. The following table shows the farm livestock population in New Zealand, at intervals since 1930, expressed in terms of livestock units (a statistical unit devised to measure total livestock population). The human population and the number of livestock units per head of population are also shown:

Year	Livestock Units	Population	Livestock Units Per Head of Population
	Thousands	Thousands	
1930	7,323	1,493	4·9
1935	7,607	1,562	4·9
1940	8,054	1,637	4·9
1945	8,510	1,695	5·0
1950	8,801	1,909	4·6
1955	10,278	2,139	4·8

96. It would seem that the productive flocks and herds of New Zealand have been well maintained in proportion to the human population over the last twenty years.

97. During the last five years particularly, increased carrying capacity has caused the farmer to withhold from the market stock which could otherwise have been sold. The country, therefore, has not yet had the full benefit of the increased carrying capacity through higher exports, except in the case of wool.

External Trade

98. During the past twenty-one years there have been times when changes in overseas transactions have exercised a powerful influence upon incomes and prices in New Zealand. It has already been remarked that during the war and early post-war years substantial surpluses of exports and other receipts over imports and other payments arose because it was impossible to secure a flow of imports corresponding to buoyant export incomes. A similar surplus arose from the wool boom in 1951. The following figures show the fluctuations during the six years ended June 1955:

Year Ended June	Surplus (+) Deficit (−)	Year Ended June	Surplus (+) Deficit (−)
1950	+ 6·3	1953	+34·7
1951	+39·1	1954	+25·2
1952	−51·3	1955	−42·3

99. The following table shows that since 1935 the volume of New Zealand's external trade has risen by approximately 76 per cent:

Volume Index of External Trade
(Base: 1936–38 = 100)

Calendar Year	Imports	Exports	Total Trade
1935	72	96	85
1940	79	108	95
1945	64	94	80
1950	141	122	131
1953	133	129	131
1954	175	128	150

100. Between 1935 and 1954 the index of the volume of imports has risen by 143 per cent while the index of the volume of exports has increased by 33⅓ per cent – a much smaller proportionate increase.

101. The main reason why New Zealand has been able to expand the volume of her imports without a fully commensurate increase in the volume of her exports is that, over the whole period since 1935, export prices have risen proportionately more than import prices. In other words, New Zealand's terms of trade with the rest of the world have improved considerably since 1935. This is shown by the following table:

Index Numbers of Import and Export Prices and Terms of Trade
(Base: 1954 = 100)

Calendar Year	Import Prices	Export Prices	Terms of Trade
1935	35	25	73
1940	43	36	83
1945	62	44	71
1950	84	92	110
1954	100	100	100

102. New Zealand's terms of trade deteriorated substantially during the depression years, reflecting the marked slump in prices for agricultural and pastoral produce. In 1933 the index (base: 1954 = 100) was 59; it improved considerably to 92 by 1937 but declined again during the war to 67 in 1944. Since 1948 there has been substantial improvement, as follows:

Index of Terms of Trade
(Base: 1954 = 100)

Calendar Year	Index Numbers	Calendar Year	Index Numbers
1948	80	1952	81
1949	85	1953	96
1950	110	1954	100
1951	111		

The years 1950 and 1951 reflect the effect of the wool boom.

Retail Prices

103. Much attention was focused during the sittings of the Commission on the rise in retail prices, the index of which has more than doubled since 1935. The following table shows the movement in five yearly periods:

Calendar Year	Retail Prices Index (Base: 1926–30 = 1000)	Increase Per Cent During Five Years	Average Annual Percentage Increase for Five Years
1935	837		
		24	4·8
1940	1035		
		13	2·6
1945	1170		
		21	4·2
1950	1411		
		34	6·8
1955	1892		

104. The two periods where the least increase is shown are the war and post-war reconstruction periods, during the greater part of which relatively rigid price and other direct controls were operating.

Wage Rates

105. A survey of the economic history of New Zealand during the past two decades would be incomplete without an examination of wage rates. Statistics are available showing the changes in minimum wage rates fixed by awards made by, and industrial agreements filed in, the Court of Arbitration, and fixed by orders of certain other tribunals having jurisdiction to determine rates of wages.

106. The following table shows index numbers of annual averages of nominal minimum weekly wage rates for adult male workers from 1935 to 1955, and also index numbers of effective weekly wage rates for adult males which are derived by dividing the index numbers of nominal wage rates by the corresponding all-groups index numbers of retail prices and multiplying by the base value of 1000.

(Base : 1926–30 = 1000)

Calendar Year	Index Numbers of Nominal Minimum Weekly Wage Rates (Adult Males) All Industrial Groups	Index Numbers of Effective Weekly Wage Rates (Adult Males)
1935	858	1025
1940	1130	1092
1945	1381	1180
1950	1793	1271
1951	2039	1302
1952	2143	1270
1953	2284	1294
1954	2459	1331
1955	2545	1345

107. In 1931, pursuant to the Finance Act of that year and as a consequence of the depression, rates of remuneration prescribed in awards and industrial agreements were reduced by 10 per cent under a general order made by the Court of Arbitration and operating from the first week in June 1931.

108. From 1 July 1936 wage and salary rates were in general restored to pre-depression levels by the Finance Act 1936.

109. In 1937 the Court of Arbitration made a wage pronouncement fixing new standard hourly rates for skilled, semi-skilled, and unskilled adult male workers. This pronouncement had no immediate effect on wage rates, but during the ensuing two years the minimum rates prescribed in new awards and industrial agreements were progressively brought into line with the Court's standard rates.

110. Following upon the outbreak of war, and with the object of providing machinery to enable minimum wage rates to be adjusted promptly to meet rapid economic changes, the Rates of Wages Emergency Regulations 1940 were brought into operation. These regulations empowered the Court, after taking into account the economic and financial conditions affecting trade and industry in New Zealand and the cost of living, to make general orders increasing or reducing all rates of remuneration prescribed in awards and industrial agreements for the time being in force. Two general orders were made by the Court

under the regulations, one which increased all rates by 5 per cent and operated from 12 August 1940, and the other which also involved an increase of 5 per cent, but with certain limiting conditions, and which operated from 7 April 1942.

111. The Rates of Wages Emergency Regulations were superseded on 15 December 1942 by the Economic Stabilisation Emergency Regulations 1942. Under these regulations all rates of remuneration were stabilised, but the Court of Arbitration was empowered under certain conditions to make general orders increasing or reducing minimum rates. Later the Court was also authorised to make standard wage pronouncements. Such pronouncements had no operative effect in themselves, but the regulations empowered the Court to vary immediately all awards and agreements by individual amendments to bring the minimum rates prescribed therein into line with the standard rates named in a pronouncement. This system enabled a reasonable relationship to be maintained between the minimum rates of remuneration prescribed in approximately 550 awards and agreements. Standard wage pronouncements were made in 1945, 1947, 1949, and 1952. General orders were made in 1950, 1951, 1953, and 1954. The 1951 General Order prescribing an increase of 15 per cent incorporated the 1950 General Order which was of an interim nature and which provided for an increase of 5 per cent with limitations following upon the withdrawal of Government subsidies on several classes of widely used goods.

112. An increase of 10 per cent with certain limitations was awarded in the 1953 General Order to operate from 15 September 1953, and in 1954 this figure was increased to 13 per cent with similar limitations to operate from 18 November 1954.

113. The regulations were amended on numerous occasions. In 1950 they were revoked, and their place was taken by the Economic Stabilisation Regulations 1950 made under the Economic Stabilisation Act 1948. These regulations abolished the power of the Court to amend all awards and industrial agreements simultaneously with the making of a standard wage pronouncement and at the same time abolished control of maximum rates. The former power was restored by the Economic Stabilisation Regulations 1952, but was again withdrawn by the Economic Stabilisation Regulations 1953 which are still in operation.

114. In making general orders increasing or reducing rates of remuneration under the current regulations, the Court is directed to take into account:

(a) Any rise or fall in retail prices as indicated by any index published by the Government Statistician;

(b) The economic conditions affecting finance, trade, and industry in New Zealand;

(c) Any increase or decrease in the volume and value of production in primary and secondary industries of New Zealand;

(d) Relative movements in the incomes of different sections of the community;

(e) All other considerations that the Court deems relevant.

115. In reviewing our economy, however, it is not sufficient to examine the changes in minimum wage rates only. Total wage costs which have ultimately to be met by consumers are a reflection of the actual earnings of workers. It is well known that actual wages paid in

industry have advanced more rapidly since the end of the war than minimum prescribed rates. Statistics disclosing the exact position are not available; but it is believed that the general trends are roughly indicated in the following tabulation which compares the average prescribed minimum rates for adult male workers with the average weekly payout to all classes of workers:

Average Prescribed Minimum Rates of Adult Male Workers Compared With Average Weekly Payout to All Classes of Workers (Males, Females, and Juniors)

Half Year Ending	Average Weekly Wages	
	Nominal Minimum Weekly Wage for Adult Males as Prescribed in Awards and Industrial Agreements as at End of Preceding Month	Average Weekly Payout (Including Overtime) for Male, Female, and Junior Workers Combined in a Week Ending in the Mid-month Pay Period
	£	£
April 1946	6·250	6·292
October 1946	6·375	6·416
April 1947	6·433	6·663
October 1947	6·492	6·954
April 1948	6·950	7·375
October 1948	7·008	7·388
April 1949	7·150	7·733
October 1949	7·613	8·071
April 1950	7·625	8.225
October 1950	8·042	8·788
April 1951	8·982	9·758
October 1951	9·196	10·154
April 1952	9·300	10·392
October 1952	9·725	10·650
April 1953	9·746	11.071
October 1953	10·741(1)	11·104(2)
April 1954	10·748	12·121
October 1954	10·818	12·350
April 1955	11·230	12·758
October 1955	11·286	13·200

(1) Includes retrospective payments following Court's General Order of 1953.
(2) Excluding retrospective payments following Court's General Order of 1953.

116. In April 1946 there were many workers receiving wages in excess of the prescribed minimum rates and an appreciable amount of overtime was being worked. It happened that at that date these factors were just sufficient in their effect to bring the average earnings of all workers (males, females, and juniors) up to a point very slightly in excess of the average minimum prescribed weekly wage rate for adult males.

117. Since that date, however, an ever-increasing margin has been established by the average actual weekly payout for all workers over and above the adult male rate. It will be seen that, whereas in April 1946 the margin was 10d. per week, by October 1955 it had expanded to £1 18s. 3d. per week. This amount does not represent the average additional sum being earned today in excess of minimum prescribed rates, because, as has already been mentioned, many workers were, in April 1946, receiving wages in excess of minimum rates, and also working overtime.

118. From a close examination of the foregoing table it will also be seen that the widening of the margin between the two sets of figures has been spectacular during the past eighteen months.

From April 1954 to October 1955: While adult male rates rose by 10s. 9d. per week, average actual payout increased by 21s. 7d. per week.

From October 1954 to October 1955: While adult male rates rose by 9s. 4d. per week, average actual payout increased by 17s. per week.

From April 1955 to October 1955: While adult male rates rose by 1s. 1½d. per week, average actual payout increased by 8s. 10d. per week.

119. It is very significant to find that during the last six months average actual payout has increased eight times as fast as prescribed minimum adult rates despite the fact that a credit squeeze is declared to be in operation. We do not think that much of this increase can be ascribed to working more overtime.

120. The sum of £1 18s. 3d. per week, referred to above, when spread over all employees in the country represents over £50 million per annum, a sum equal to about 11 per cent of the total wage bill for 1954–55.

121. It is obvious that the outstanding feature of the wage situation during the post-war period has been the progressive increase in the size of the margin between prescribed minimum rates and actual rates, and that the latter at the moment are increasing much faster than the former. No doubt the position is directly due to over-full employment which, in turn, is due to factors other than the operations of wage-fixing authorities.

122. Wages being the principal constituent of costs, it is manifest that, while such conditions continue, it is impossible to expect stability in prices of locally produced consumer goods and services.

Capital Investment

123. This table illustrates the marked changes in the level of capital investment since 1933:

Gross Capital Investment (Excluding Changes in Stocks) as a Percentage of Gross National Income

Year Ended March	Private	Government, Including Local Authority	Total
1933	4	5	9
1938	7	8	15
1943	2	3	5
1948	9	7	16
1953	13	10	23
1955	14	9	23

124. Here is shown the recovery from the depression, the fall in capital investment during the war, the recovery during the post-war years, and the comparatively higher rate of capital development in recent years. The table also shows the relatively greater growth since 1938 of private compared with Government and local authority expenditure.

The Building and Construction Industries

125. Already in 1937 there was evidence of shortage of skilled labour in the building industry. The 1938 Budget contained this comment about the State housing scheme:

> It was realised at the commencement that the progress of the housing scheme would depend very largely on the availability of skilled labour. The operations of the Department are, at the moment, being seriously delayed on account of this factor. The average number of artisans employed by the contractors is only 1·8 (per house). This figure explains the long period required by many builders to finish their contracts.

In November 1938 the figure of 1·8 had fallen to an average of 1·5 artisans per house under construction. To remedy this situation, special arrangements were made to recruit building artisans in the United Kingdom and Australia.

126. Since 1938 the building and construction industry has been under considerable pressure and, at times, very great pressure of demand for its services. The increased demand was reflected in higher prices and, to some extent, the higher demand led to an increase in the labour force employed in the industry.

127. From 1946–47 to 1954–55 the labour force employed in the building and construction industry increased from 49,300 to 69,200 or by approximately 40 per cent. In the same period the total labour force increased by 14 per cent. In 1946–47 some 7 per cent of the labour force was employed in the building and construction industry, and in 1954–55 the percentage was 8·6.

128. The changes in the volume of house building, an important section of the building industry, are a striking indication of economic conditions generally. These changes are illustrated in the following table of building permits for urban districts:

Year Ended March	Number	Year Ended March	Number
1933	1,496	1953	11,700
1938	6,043	1954	12,596
1943	863	1955	15,443
1948	9,854		

Savings

129. There is no one statistical total of savings entirely suitable for use as an indicator of the general level of savings in the community over the last twenty-one years. The main components of total private savings are:

(a) Small savings – i.e., Post Office Savings Bank, trustee savings banks, national savings, etc.
(b) Corporate savings – i.e., undistributed profits of companies.
(c) Contractual savings – life insurance provisions, superannuation, mortgage repayments, net repayments under hire-purchase agreements, etc.
(d) Accumulations in farm industry accounts and wool retention accounts.
(e) Savings of farmers and unincorporated businesses apart from those included in (a) to (d) above.

130. The following table shows the movement in "small savings" since 1934–35 as a percentage of gross national income:

Year Ended March	Amount of Increase	Percentage of Gross National Income
	£ million	
1935	5·0	3·67
1940	—2·7	−1·07
1945	26·8	7·07
1950	12·4	2·24
1955	14·0	1·51

131. Details of corporate savings (i.e., undistributed profits of companies) are not available except for the following years:

Year Ended March	Corporate Savings	Percentage of Gross National Income
	£ million	
1950	19	3·4
1951	26	3·7
1952	25	3·5
1953	20	2·7
1954	30	3·6

132. Retention of profits is particularly important when the cost of replacement of capital equipment is rising and when normal depreciation rates may not ensure adequate finance for replacements. Because the necessary data is not available it is not practicable to compare recent undistributed profits with those of pre-war years.

133. Nor is there sufficient information available to enable a comprehensive comparison to be made of the present level of contractual savings with that of earlier periods. However, a major part of these savings consists of repayments of table mortgages. The following table shows the total amount of repayments to the State Advances Corporation at intervals since 1939–40 in respect of residential mortgages:

Year Ended March	Total	Percentage of Gross National Income
	£ million	
1940	1·17	0·47
1945	1·80	0·48
1950	2·28	0·41
1955	5.80	0·63

134. Life insurance premiums contain important elements of saving. The following table shows the total life insurance premiums payable in respect of life policies in existence at the end of the year at five yearly intervals since 1935:

Calendar Year	Total Premiums	Percentage of Gross National Income
	£ 000	
1935	3,466	2·6
1940	4,756	1·9
1945	6,546	1·7
1950	10,936	2·0
1953	15,134	2·0

135. For a time accumulations in the farm industry reserve accounts made an important contribution to total savings in New Zealand. The following statement (which also includes the wool retention accounts) shows the position during the war and post-war years:

Farm Industry Reserves (Including Wool Retention Accounts)

Year Ended July	Total	Increase for Year	Increase as Percentage of Gross National Income
	£ 000	£ 000	
1942	750	750	0·26
1943	1,884	1,134	0·34
1944	5,384	3,500	0·94
1945	13,835	8,450	2·23
1946	16,905	3,071	0·77
1947	23,249	6,344	1·50
1948	39,837	16,589	3·45
1949	54,254	14,416	2·95
1950	72,283	18,030	3·27
1951	118,823	46,539	6·68
1952	118,804	−19	..
1953	114,014	−4,790	−0·64
1954	108,832	−5,182	−0·62
1955	102,229	−6,603	−0·71

136. The decline in small savings and the cessation of accumulations in farm industry reserves have been offset by a growth in Government savings through a surplus of revenue over expenditure on current account. The estimates of national income published by the Department of Statistics show that in 1938–39 the Government surplus on current account was £1·5 million or 0·6 per cent of the gross national income. In 1954–55 the surplus on current account was £54 million or 5·8 per cent of the gross national income.

137. The Commission does not consider that the detailed statistics of private savings are sufficiently comprehensive to enable general conclusions to be drawn, but there are indications of substantial decreases during the post-war period in the proportion which certain classes of savings, notably "small savings" and, in recent years, accretions to farm industry accounts, bear to the gross national product. This decrease has taken place during a period of high and increasing investment programmes when a high level of savings is essential to offset the inflationary effects of capital expenditure.

Summary of Main Periods

1934 to 1939

138. New Zealand's recovery in the years from 1934 to 1939 was part of a world recovery; it was assisted by internal policies including increased Government spending. By 1938 unemployment had been very substantially reduced. The expansion of Government and other spending brought its own problems; production lagged behind expanded incomes and the demand for imports exceeded export earnings. The drain on overseas funds resulting from this increased demand and from substantial remittances of capital from New Zealand led to the imposition of import and exchange control in December 1938. Although the Reserve Bank began business in 1934 and passed into full Government ownership and control in 1936, no significant Government borrowing from the bank took place until 1938.

1940 to 1945

139. The inflationary situation of 1939 was soon worsened by war expenditure; by the diversion of labour, materials, and industrial capital to war purposes; and by lack of imports for civilian use. During the war years the general stabilisation scheme (in which all sections of the community co-operated under the spur of war conditions) and sound budgetary policies did much to curb the tendency for prices to increase. Government borrowing from the banking system was comparatively slight in the circumstances. Throughout the war, partly because of lack of goods and services available for purchase, the level of savings was high.

1946 to 1949

140. The period 1946 to 1949 began with a shortage of houses and a backlog of Government and private capital works which had been necessarily postponed during the war. Both Government and private capital expenditure expanded quickly. Some surplus purchasing power was withdrawn from the public by high taxation and Government borrowing, partly to finance purchase by the Government of sterling funds for repayment of overseas debt. Price increases were limited by subsidies and by continuing some direct controls, which were also used to limit imports. Compared with other countries New Zealand was very successful in restraining price increases between 1939 and 1948. The restoration of the New Zealand pound to parity with the United Kingdom pound was a timely adjustment which curtailed rising export incomes and limited the effects in New Zealand of rapidly rising import prices.

1950 to 1955

141. In the period 1950 to 1955 price increases were steeper than in previous periods. Part of this increase arose from removal of stabilisation measures which previously had restrained price increases. Other potent factors were rising prices overseas and high and increasing public and private capital investment for which an adequate supply of savings was not always forthcoming. During this period and especially towards its end

this lack of savings, coupled with the demand for loan moneys, led to an upward pressure on interest rates. The wool boom of 1951 expanded wool-growers' incomes, and brought an accession of overseas exchange which enabled control of imports to be dispensed with until April 1952, when the flood of imports led to exchange allocation.

142. In 1953–54, partly as a sequel to and as a result of the wool boom during which some people had spent very heavily and others had over-imported in relation to the immediate demand, there was a lull in business. This was followed by a fall in demand for imports and by a drop in the number of vacancies for employment in industry. About mid-1954 there was a renewed demand for imports; there were increased industrial vacancies for employment; and there were widening margins between award rates and wages paid or offered by employers.

General

143. Using the base 1926–30 = 1000, the index of retail prices in 1934 had fallen to 808. This represented an increase in the value of the pound from 20s. in 1926–30 to 24s. 9d. in 1934. Between 1934 and 1955 the index rose to 1892 and the retail purchasing power of the pound therefore fell to 10s. 7d. on the 1926–30 basis of computation.

144. The Commission considers that the use of 1926–30 as a base gives a more reasonable comparison than that given by certain witnesses who compared the present purchasing power of the pound with that of 1934 and put it at only 8s. 5d. compared with 20s. in 1934.

145. Over the period 1934–35 to 1954–55 the gross national income increased from £135·6 million to £926·8 million or from an average of almost £80 per head in 1934–35 to £440 per head in 1954–55. It would seem, therefore, that the increase in average incomes per head far more than offset the fall in purchasing power since 1934–35.

Conclusion

146. The foregoing summarises the events of the twenty-one years during which New Zealand emerged from a depression, and shared the burden and stresses of a world war. Throughout almost the whole of this period the country had the benefit of rising export prices. During that time New Zealand's economy was adjusted to meet the needs of a rapid increase in population, and at the same time major social reforms were effected. In spite of the difficulties peculiar to a young country dependent on overseas markets for its few principal products all this was accomplished with orderly development. The principal strains evident in the last few years have been those associated with a high degree of prosperity and with buoyant export and other incomes.

147. In 1934, as in the four preceding years, capital investment, both public and private, was very low. Because there were 50,000 unemployed, total earnings were insufficient to provide an effective demand for all that could have been produced or imported. Although export prices had only slightly recovered from the very low level in 1931, overseas funds had been accumulated owing to the lack of demand for imports. Public confidence in the economic future was at a low ebb.

148. In 1955, on the contrary, capital investment is at a high level, and there are vacancies in industry for some 25,400 more people than are available. The level of incomes is so high that there is a demand for imports greater than can be met from available overseas funds. Export incomes are buoyant; there is confidence in future prospects. In short, the outlook has changed from depression to prosperity, from severe unemployment to over-full employment, and from deflation to inflation.

149. We turn now to an examination of what constitutes "money" and to an historical analysis of the monetary, banking, and credit systems of New Zealand during the past twenty-one years.

Section Four

THE MONETARY, BANKING, AND CREDIT SYSTEMS, 1934–55

Introduction

150. In Appendix C we examine in detail the definition of "money" and how it is created and controlled, the causes of changes which have taken place in the money supply in recent years, and the structure and operation of the monetary, banking, and credit systems in New Zealand, with particular reference to the period since 1934. In this section of our report, we provide only a necessary outline.

Money and Credit

151. Money is anything which is immediately available and generally acceptable in payment for goods and services or in settlement of a debt. In New Zealand, there are three things which appear to us to satisfy these criteria of immediate availability and general acceptability:

(a) The coin and notes in circulation:

(b) The deposits on current account standing to the credit of the customers of the trading banks, or to the credit of the Government and various marketing authorities at the Reserve Bank:

(c) The unexercised portion of overdraft authorities granted to customers by the trading banks.

152. The two latter types of money are entries in the books of a bank, recording the obligation of the banker to his customers, but the banker, when he is directed to do so by cheque, will immediately transfer to other people a sum up to the amount which stands to each customer's credit or up to the amount by which he has authorised each customer to overdraw his account. Nowadays, a very large proportion of payments is made by cheques drawn against demand deposits or against overdraft limits.

153. It should be noted that there is no universally accepted definition of money. The Reserve Bank, for instance, includes notes and coin in circulation, demand deposits of customers at the trading banks, and deposits of the Government and marketing authorities at the Reserve Bank, but does not include unexercised overdraft authorities in its definition. The Australian authorities include all savings-bank deposits as money. For reasons given in Section One of Appendix C, we believe that the items listed in paragraph 151 above, and these alone, should be regarded as money for statistical purposes in New Zealand. However, since this view has not as yet been accepted, we shall adhere to the Reserve Bank definition of the money supply in this report, although we shall examine from time to time the importance of unexercised overdraft authorities as a means of payment.

154. To grant credit is to make available money, goods, or services now, in return for a promise to pay or repay in the future. Usually a charge is made for the credit, in the form of an agreed rate of interest to be paid by the debtor on the sum lent.

Changes in the Money Supply in Recent Years

155. As the following table shows, the volume of money, as defined by the Reserve Bank, rose from £46 million at the end of June 1935 to £317 million at the end of June 1955, an increase of £271 million, or about 600 per cent. If unexercised overdraft authorities are included, the volume of money rose from £77 million in 1939 to £417 million in 1955.

Volume of Money in New Zealand, Together with Unexercised Overdraft Authorities, 1935 to 1955

(£ million)

(Last balance day in June)

—	1935	1939	1943	1945	1949	1951	1952	1954	1955
Coin in circulation ..	0·9	1·4	2·3	2·7	3·2	3·6	3·8	4·1	4·3
Notes held by public ..	6·1	11·5	27·5	34·5	42·3	48·4	50·1	57·1	59·0
Demand Deposits at—									
Reserve Bank	13·3	2·5	23·7	15·3	8·1	13·5	12·0	10·5	15·1
Trading banks	25·9	37·3	79·0	96·9	153·6	211·9	192·2	240·6	238·6
Total (Reserve Bank definition)	46·2	52·7	132·5	149·4	207·2	277·4	258·0	312·3	317·0
Unexercised overdraft authorities	N.A.	24·0	36·2	38·8	58·7	76·4	68·8	111·7	100·1
Total (including unexercised overdraft authorities)	N.A.	76·7	168·7	188·2	265·9	353·8	326·8	424·0	417·1

156. The table shows that the largest part of the supply of money is that held by customers of the trading banks in their current accounts. In addition, customers of the trading banks throughout the period have had available for spending substantial amounts in the form of unused authorities to overdraw their accounts. These two items together totalled nearly £339 million in June 1955.

Causes of Changes in the Money Supply: General

157. The volume of money (on the Reserve Bank definition) is increased:

(a) When a customer of the Reserve Bank or a trading bank lodges, to the credit of his account, foreign exchange received from the sale of goods or services beyond New Zealand, from gifts or legacies from persons overseas, or from the proceeds of a loan raised with an overseas lender.

(b) When the Reserve Bank or a trading bank buys securities or other assets from an individual or firm and the proceeds are lodged to the credit of the seller's account at a bank.

(c) When the Reserve Bank makes a loan to the Government or to marketing authorities. At first, the borrower's deposits at the Reserve Bank are increased, and when this money is spent, the recipients may lodge part of it in their accounts at the trading banks and retain part of it in circulation in the form of notes and coin.

(d) When the customer of a trading bank draws on an overdraft limit granted by the bank and the recipient of his cheque lodges it to the credit of his account at a bank.

158. Conversely the volume of money (on the Reserve Bank definition) is reduced:

(a) When a customer of the Reserve Bank or a trading bank buys, with a deposit in his name at the bank concerned, foreign exchange to meet obligations overseas.

(b) When the Reserve Bank or a trading bank sells part of its holdings of securities or other assets to persons with credit accounts at a bank.

(c) When the advances of the Reserve Bank are reduced, by the lodgment of notes, coin, or cheques drawn on credit accounts.

(d) When the advances of the trading banks are reduced, by the lodgment of notes, coin, or cheques drawn on credit accounts.

159. For the sake of clarity, it has been assumed in each of the transactions in paragraph 157 above that the customer making the lodgment at a bank was making it in a credit account. The position would be different if he were working on a bank overdraft, for if he used the funds to reduce his overdraft (or to buy overseas exchange) there would be no increase in demand deposits and therefore no increase in the volume of money. Similarly, the transactions outlined in paragraph 158 would not result in a reduction of the supply of money if the funds used to buy the exchange, securities, or other assets, or to reduce the advances, had come from an overdraft account or from the lodgment of foreign exchange.

160. If unexercised overdraft authorities were included in the definition of the supply of money, as we suggest, the supply of money would be increased immediately a customer was granted an overdraft limit, for the customer would then be in a position to draw cheques against the overdraft authority to the amount of the limit granted to him. Again, the transactions outlined in paragraph 157 would increase the volume of money, even if the customer making the lodgment were working on overdraft, as long as his overdraft limit was not reduced. For to the extent that he repaid an advance, the unexercised portion of his overdraft limit would be correspondingly increased. On the other hand, on the suggested definition, the supply of money would be reduced immediately if customers' overdraft limits were reduced.

161. It is important to recognise the difference in the effect on the volume of money between lending by or the purchase of assets by a bank on the one hand, and lending by or the purchase of assets by an individual or firm on the other. In the latter case, the individual or firm making the loan or buying the asset parts with his money to the borrower or seller; when a bank lends or buys assets, however, none of those who already held demand deposits before the transaction took place gives up his right to use that deposit when he wishes; i.e., no part of the supply of bank money existing before the transaction is withdrawn, but the borrower, or the seller of the asset bought by the bank, usually receives new bank money in the form of a deposit or of an increase in his unexercised overdraft limit at the bank. An increase in bank lending or purchase of assets therefore normally involves an increase in the total volume of money available to the public.

162. Thus, during any period, the volume of money is likely to increase:

(a) If the trading banks and/or the Reserve Bank increase their lending, or purchase more assets, during the period; and/or

(b) If there is an excess of export earnings and other receipts from persons overseas over import and other payments to persons overseas (i.e., if there is a surplus in our balance of payments).

163. Conversely, the volume of money is likely to fall if lending, or purchase of assets, by the Reserve Bank and trading banks declines, or if there is a deficit in our balance of payments.

Creation of Money by the Trading Banks

164. The fact that a large proportion of our money supply comes into existence as a result of the operations of the trading banks obviously disturbed many witnesses who appeared before us. A number seemed to think that this "creation of credit" by the banks was a relatively recent phenomenon. In fact, the fundamental principles of our banking system have remained much the same since at least the seventeenth century. Nor is the fact that this "creation" takes place a very recent discovery, as some witnesses implied. The quotations cited in Appendix D, Part II, show this clearly.

165. Trading banks cannot increase their lending, and thus create money, without limit and at no cost to themselves. Even if there is no control by the Government or by a central bank, a trading bank obviously cannot increase its lending if there are insufficient credit-worthy persons seeking loans. But an even more important limitation on the expansion of trading-bank lending is the necessity for each bank to keep an adequate reserve of "bankers' cash" (i.e., notes, coin, or balances at the Reserve Bank) and/or of overseas exchange. This reserve must be sufficient not only to meet any conceivable demands by its customers for notes, coin, or overseas exchange, but also to preserve their confidence in its ability to meet their requirements immediately at all times. Many banks – fortunately mainly outside New Zealand – have been forced in the past to close their doors because large numbers of customers, having lost faith in a bank's ability to meet their requirements, began a "run on the bank", seeking more legal tender money or overseas exchange for their deposits than the bank could immediately supply.

166. An expansion of lending is almost certain to lead to a withdrawal of bankers' cash from the banks concerned. This is particularly true in the case of an individual bank competing with several others. If this one bank does, say, one-fifth of the banking business of the country, it is probable that four-fifths of any extra amounts which it lends will be paid by cheque by the borrowers to customers of other banks. When these other banks present the cheques to the original bank for payment, the latter will have to transfer to them part of its reserve of bankers' cash. Therefore, if one bank expands its lending more rapidly than its competitors, it is almost certain to lose considerable amounts of bankers' cash to them.

167. But even if one trading bank had a monopoly of the banking business of the country, or all the trading banks acted in collusion, there would still be limits to an expansion of their lending. For as their advances increased, so directly or indirectly would their customers' demand for overseas exchange to buy imports. Also, since the expansion of advances would stimulate business activity generally, more notes and coin would be required for wage and salary payments and retained in circulation outside the banks. Both developments would reduce their reserves of bankers' cash and overseas exchange.

168. The primary duty of a banker – and a basic necessity if lending is to be possible at all – is to safeguard the deposits entrusted to his care. To this end, he must so restrict his lending that he retains a reserve which bears a reasonable proportion to his customers' deposits.

169. The Chairman of the Associated Banks informed the Commission that, in his opinion, under existing conditions, a reserve of "bankers' cash" equal to about 20 to 25 per cent of his customers' deposits was a "comfortable" reserve for a New Zealand banker to hold. This means that a New Zealand bank can make loans and/or buy investments up to a value equal in total to several times its reserve of cash. The banks can hold a reserve which is only a fraction of their liabilities to their customers primarily because, in the absence of abnormal economic developments, customers as a group tend to retain at the banks a reasonably stable volume of deposits, even though they have the right to withdraw legal tender money on demand in exchange for their deposits at any time. The volume of deposits remains relatively stable largely because the bulk of the business transactions of the country is financed by the transfer of deposits by cheque. Thus, payments made by a customer of a bank tend to return as a deposit at the same or another bank. On balance, deposits and withdrawals from each bank over any short period tend to offset one another, so that there is no net drain of cash into circulation. If the banks' deposit liabilities had not become the primary means of settling accounts in the economy, their ability to lend would have been severely limited, for any expansion of lending would have resulted in a substantial loss of legal tender money into circulation. In other words, the trading banks' power to "create money" depends on the fact that a large section of the community uses the banks' liabilities as money.

170. Given the proportion of the customers' deposits which they deem it prudent to keep as reserves of bankers' cash and foreign exchange, the extent to which the banks may lend is dependent upon the amount of reserves which they can acquire. This depends:

(a) On the balance of payments. The banks' reserves rise when there is a surplus and fall when there is a deficit in the balance of payments.

(b) On the extent of the lending of the Reserve Bank. The trading banks' reserves rise when the Reserve Bank increases its lending and fall when the Reserve Bank reduces its lending.

(c) On the proportion of the country's supply of money which the community is prepared to keep in the form of deposits with the banks, rather than in the form of notes and coin in circulation outside the banks.

171. The attraction of the deposits which provide the bank with the basis for its lending is not a costless process, even though the banks pay no interest on deposits on current account. People place deposits on current account primarily because the bank provides them with the safe and convenient facility of being able to transfer their funds to other people by cheque. In New Zealand, this service is rendered at a charge which by no means covers the direct costs involved, which are substantial. (See paragraph 65 of Appendix C.)

Control of Trading-bank Lending

172. In New Zealand, lending by the trading banks is also subject to control by the Reserve Bank and by the Government.

173. The Reserve Bank has power to require the banks to keep a minimum reserve balance at the Reserve Bank and, subject to the consent of the Minister of Finance, to vary from time to time the minimum proportion which this reserve balance must bear to the demand and time deposits of customers of the banks, provided that the proportions are not reduced below 7 per cent of demand deposits and 3 per cent of time deposits. If the Governor of the Reserve Bank thinks that the banks are lending too freely, he is in a position, with the authority of the Minister of Finance, to raise the minimum reserve requirements, so that the banks are forced to borrow money from the Reserve Bank to maintain the required minimum reserve. The Reserve Bank also has power to vary the rate of interest at which it will lend to the banks. It can be seen that these powers could be used, if the authorities wished, to make an unwanted expansion of advances completely unprofitable to the banks and to provide them with a direct financial inducement to keep advances within desired limits.

174. The Government can also reduce the trading banks' reserve balances, and therefore their ability to lend, by collecting from the public by taxation and borrowing during any period more than it spends during the same period; for the cheques drawn on the trading banks by taxpayers or subscribers to Government loans are paid by the Government into the Reserve Bank, which takes payment from the trading banks by reducing their deposits (i.e., reserve balances) at the Reserve Bank.

175. During and since the war, the Government has taken other steps to control the level and direction of lending by the trading banks. First, since 1942, with the co-operation of the trading banks themselves, a policy of selective control by the Reserve Bank of bank advances has been in operation. Secondly, from 1943 onwards, as a matter of Government policy, purchases of Government securities by the trading banks have been restricted. (See paragraphs 188 to 190 below.)

176. To sum up, the extent to which the trading banks can lend or buy assets, and increase the supply of money, depends on several factors:

(a) The amount of bankers' cash (i.e., notes, coin, and balances at the Reserve Bank) and foreign exchange which they can obtain, for they must keep a prudent relationship between these assets and their liabilities to their customers. (In turn, their holdings of cash and foreign exchange are influenced by the country's balance of payments, the Government's fiscal policy, and the extent to which the public wish to hold notes and coin in circulation.)

(b) The proportions of their customers' deposits which they are required under the reserve ratio system to maintain as balances at the Reserve Bank.

(c) The other controls over advances and investments imposed by the Reserve Bank and the Government.

(d) The demand by credit-worthy members of the public or by the Government for bank credit. A bank cannot lend if nobody wants to borrow.

The Government and the Creation and Destruction of Money

177. It can be seen from the above that the Government, working through the Reserve Bank, has far-reaching powers to curb unwanted bank lending. Through its ownership of the Bank of New Zealand, which in 1954 handled about 40 per cent of the advances and deposit business of the trading banks in New Zealand, it can also, if it so desires, reinforce its general policy as regards bank lending, and influence bank charges by specific instructions to the Bank of New Zealand. Bank overdraft rates have been fixed by agreement between the Government and the Associated Banks since 1941.

178. If the Government considers at any time that the supply of money is inadequate, and the trading banks cannot or will not increase their lending, it may itself borrow from the Reserve Bank, and no doubt, in practice, set its own terms as to interest charges and repayment. Indeed, if it wished, it could ensure, with its existing powers, that the trading banks did not initiate any expansion of the money supply required in the future, and that all new money was advanced by the Reserve Bank to the Government. As we point out elsewhere in this report, we consider that this would be most undesirable. However, the above remarks indicate the extent of the Government's power to control the supply of money and the terms on which it is issued.

179. Two factors which have always had to be taken into account in determining to what extent bank lending should be expanded in New Zealand are the country's overseas trade position and the level of its exchange reserves. Before the Reserve Bank was set up in 1934, it could be said that these were the primary factors governing the lending policy of the trading banks, and, therefore, the supply of money in New Zealand. Inevitably, in a dependent economy, they must remain major factors in the monetary policy of the Government and its Reserve Bank. If the money supply is expanded, whether by trading-bank or by Reserve Bank credit, it is probable that the community's spending will increase. If persons are free to spend money overseas as they wish, New Zealand's imports and other overseas payments may be expected to rise by an amount equivalent to about 30 to 40 per cent of any increase in total spending. This sets obvious limits to the extent to which the money supply can safely be expanded, especially if the Government wishes to permit a reasonable degree of freedom to citizens in their overseas transactions.

180. The experience of the past two decades, when the supply of money (on the Reserve Bank definition) has been expanded by £271 million without disastrous results, may seem at first sight to be inconsistent with this conclusion. But it must be remembered that, during this period, annual export earnings also increased by over £200 million; that there were recurrent shortages of imports during the war and early post-war years; and that a comprehensive system of import and exchange control was in operation between 1939 and 1950, and exchange allocation between 1952 and 1954. Balance-of-payments difficulties were encountered in 1938, and (despite very high export earnings) in 1951–52 and 1954–55. These difficulties bear witness to the continued need for the monetary authorities to prevent an unwarranted expansion of the money supply and more important, of domestic spending, if external trade is to be left relatively free of restriction and our reserves of overseas exchange are to be maintained at an adequate level.

Causes of Changes in the Money Supply in New Zealand Since 1935

181. The main direct causes of the increases which have taken place in the volume of money (as defined by the Reserve Bank) in New Zealand during selected periods between June 1935 and June 1955 are given in the following table:

Causes of Change in the Volume of Money
(£ million)

Years Ended June	Total Change	Overseas Transactions	Government Borrowing from Banks	Trading Bank Advances and Discounts	Shifts in Wool Retention Accounts	Other
1935 to 1939 ..	+ 6·5	−36·5	+17·0	+ 9·9	..	+16·1
1939 to 1943 ..	+ 79·8	+33·8	+56·2	− 13·1	..	+ 2·8
1943 to 1945 ..	+ 16·9	+39·3	−24·8	+ 10·6	..	− 8·1
1945 to 1949 ..	+ 57·8	+16·8	+ 6·7	+ 27·5	..	+ 6·8
1949 to 1951 ..	+ 70·2	+43·3	−14·5	+ 52·7	−20·9	+ 9·6
1951 to 1952 ..	− 19·3	−48·7	− 6·0	+ 40·3	− 7·8	+ 2·9
1952 to 1954 ..	+ 54·3	+64·6	− 7·6	− 23·6	+12·0	+ 8·9
1954 to 1955 ..	+ 4·6	−35·5	− 7·5	+ 34·8	+ 5·8	+ 7·0
	+270·8	+77·0	+19·5	+139·1	−10·9	+46·0

182. The major increases in the money supply occurred during the war years, mainly as a result of an excess of receipts over payments in our external transactions, and in the period since 1950, mainly from increases in trading-bank advances. An outline of the changes within each period appears in Section Two of Appendix C.

183. Over the period as a whole, just over one-half of the increase in the volume of money (£271 million) can be ascribed to increases of £139 million in the level of trading-bank advances and discounts. The second most important factor has been the surplus in overseas transactions during the period which has expanded the money supply by £77 million or 28 per cent of the increase. However, it is necessary to be cautious in the use of these figures. First, when the level of bank credit and the balance of payments are fluctuating markedly, the passing of one year may make a considerable difference to the picture. For instance, if we exclude the year 1954–55, and look at the causes of the rise in the volume of money between June 1935 and June 1954, we find that the surplus in external transactions is responsible for 42 per cent and the rise in trading-bank advances for only 39 per cent of the increase. Secondly, the major items mentioned as separate causes of the rise in the volume of money are, as we shall see below, interrelated, a change in one tending to give rise to a change in another.

Government Borrowing from the Banking System

184. The table above gives a slightly misleading picture of the extent to which Government borrowing has contributed to the increase in the money supply, in that its indebtedness at the end of June 1955 was unusually low in relation to its indebtedness for the rest of the year. The following table shows the Government's average indebtedness to the Reserve Bank and the trading-banks during the calendar years concerned:

Government Borrowing from the Banking System [1]
(£ million)

Calendar Year	Total Borrowing From Reserve Bank	Trading-bank Investments in Government Securities	Total Borrowing From Banking System
1935	1·5	4·8	6·3
1936	1·8	5·2	7·0
1938	5·4	7·6	13·0
1939	16·1	11·3	27·4
1944	43·9	36·1	80·0
1947	29·6	20·9	50·5
1950	79·1	11·7	90·8
1952	61·3	11·7	73·0
1953	70·5	11·7	82·2
1954	46·0	23·0 [2]	69·0 [2]
1955	43·3	23·1 [2]	66·4 [2]

[1] Balances in the Public Account at the Reserve Bank are not taken into account.
[2] Including holdings of State Advances Corporation stock of £11 million in 1954 and £11·5 million in 1955.

185. The most striking increase in Government borrowing from the banking system took place between 1938 and 1944. There was a fairly sharp rise in 1939 when the Government found itself unable to obtain enough money from non-banking sources to finance its expenditure, including its expanding works programme. Again, during the early years of the war, it was found impracticable to avoid resort to the banking system to pay for the Government's greatly expanded commitments, especially for defence. After 1943, the Government set its face against reliance on bank credit. By 1947, it had reduced its indebtedness to the banking system by £30 million from the peak of £80 million reached in 1944.

186. However, this reduction was more than offset in the next two or three years, and, by 1950, the Government's debt to the banking system had risen to over £90 million. £20 million of the increase can be attributed to an issue of Government securities to the Reserve Bank as compensation for a loss which the bank incurred on its holdings of foreign exchange as a result of the appreciation of the exchange rate in 1948. This merely provided the bank with an interest-bearing security and did not add to the volume of money in New Zealand. The bulk of the remainder of the increase took place in the financial year 1949–50 to finance part of the Government's works programme, due to a shortage of investment money after the exchange adjustment of 1948.

187. Since then, with the exception of 1952–53, when the Government decided not to raise a public loan in an endeavour to relieve pressure on the limited funds then available, the Government's debt to the banking system has been consistently reduced. Its average indebtedness in 1955 was £66 million, about £25 million below the average for 1950.

188. As the table above indicates, there have been important changes in Government policy towards borrowing from the trading banks during the period considered. Up till 1943, it was normal practice for the trading banks to invest in Government loans, and from 1936 to 1943 their investments in Government securities rose from £5·2 million to £36·1 million. As from 1943, the Government decided not to permit the trading

banks to subscribe to Government loans and repaid their existing securities as they matured. As a result of this policy, the banks' holdings of Government securities had fallen to £11·7 million by 1950, a figure very little above that ruling in 1939.

189. The new Government continued the policy of preventing the banks from subscribing to Government loans, but permitted them to maintain their existing holdings at a level of about £11·7 million. Apart from a temporary investment of £0·5 million by one of the banks in 1954, there has been only one departure from this policy since 1950. In January and March 1954 the banks were invited to invest a total of £12 million in State Advances Corporation stock to assist in financing the Government's housing programme.

190. The relative effects on the supply of money of borrowing from the Reserve Bank and from the trading banks are considered in Section Five of this report, and in Section Two of Appendix C. It will be noted that additional borrowing from the Reserve Bank not only increases directly the supply of money in New Zealand, but also, by adding to the reserve balances of the trading banks, makes it possible for them to increase their lending, unless prompt and appropriate increases are made in the minimum reserve ratio requirements.

Trading-bank Credit and Its Control

191. In the light of the banks' relatively low holding of securities, and in the absence of any short-term money market which would enable them to invest in commercial or Treasury bills as can banks in countries with more highly developed money markets, the banks have to rely heavily on advances to customers as an earning asset.

192. We indicated in the previous section that trading-bank advances had been responsible for £139 million or just over one-half of the total increase in the volume of money of £271 million between June 1935 and June 1955. The following table shows that the bulk of the increase in trading-bank advances has taken place since 1949:

Year Ended June	Change in Trading-bank Advances and Discounts (£ million)	
1935 to 1939	+ 9·9	+ 34·9
1939 to 1943	− 13·0	
1943 to 1945	+ 10·5	
1945 to 1949	+ 27·5	
1949 to 1951	+ 52·7	+104·2
1951 to 1952	+ 40·3	
1952 to 1954	− 23·6	
1954 to 1955	+ 34·8	
	+139·1	

193. We have seen that the extent to which banks can lend depends on these factors:

(a) The ratio which the banks' basic reserves bear to their deposit liabilities to customers.

(b) The ratio which they are required to keep between their balances at the Reserve Bank and their deposit liabilities.

(c) The tightness of any other controls by Government or Reserve Bank over their lending.

(d) The availability of credit-worthy borrowers wanting bank advances at the ruling rates of interest.

194. The question arises why trading-bank advances were responsible for only £35 million or 22 per cent of the increase of £161 million in the volume of money between June 1935 and June 1949. No shortage of reserves prevented a substantial expansion of bank advances during this period. Over the whole period 1935 to 1949 the banks' holdings of cash and overseas assets rose by £70 million, but bank advances rose by only about £35 million and securities by about £10 million. Thus there was no multiple expansion of bank credit on the basis of the increased reserves; in fact, the banks expanded their lending by an amount equivalent to only two-thirds of their increased holdings of cash and overseas funds.

195. Nor was their lending restrained by the level of the statutory minimum reserve ratios set by the Reserve Bank. The minimum balances required to be kept at the Reserve Bank remained throughout at 7 per cent of demand liabilities and 3 per cent of time liabilities respectively. The actual ratio maintained by the banks was always well above these figures.

196. The policy of selective advance control probably exerted some restrictive influence, but the main reason for the relatively moderate expansion of bank advances during the period 1938 to 1949 was undoubtedly lack of demand for them. Several factors were responsible for this. First, the normal volume of imports for civilian consumption was not available during the war and early post-war periods and the Government took a much larger share of the imports than before the war; secondly, during the same period, the Reserve Bank took over the financing of the marketing of many primary products; thirdly, as men were drafted into the forces, the level of business activity in New Zealand declined to some extent and many firms engaged on war contracts received advance payments from the Government; fourthly, many activities were subject to direct controls (e.g., the demand for advances for private building purposes was low because building controls prevented an undue diversion of scarce resources into this field); and fifthly, the overall stabilisation policy prevented any marked rise in prices, wages, and other costs, which, if it had occurred, would have necessitated higher advances.

197. Advances rose between 1946 and 1948 as imports increased, the banks regained the finance of wool exports, business returned to a peacetime basis, and controls were to some extent relaxed. But, even in 1948, fairly comprehensive import controls, controls over domestic prices and incomes, and building controls remained; and the financing of meat, dairy produce, and several other primary products remained with the Reserve Bank, thus restraining the demand for trading-bank credit. And in 1948–49, a small decline occurred in trading-bank advances, probably due to the general disinflationary effect and, in particular, the temporary lowering in the domestic value of imported goods, caused by the exchange appreciation of 1948.

198. The situation ruling in 1949, then, was that the banks were holding large reserves of cash and foreign exchange in relation to their deposit liabilities, were subject to no restriction through the reserve

ratio system, and had been unable to expand their advances greatly, partly because of the selective advances control policy, but primarily because of lack of demand for bank credit in the prevailing circumstances.

199. There has been a very great increase in the demand for trading-bank credit since 1949, and the trading banks have had cash reserves adequate to permit a rise in advances and discounts of £104 million between June 1949 and June 1955.

200. The Reserve Bank has been counselling restraint in the provision of credit throughout the period. Up till August 1952 it relied entirely on its selective advances control policy and therefore on the voluntary co-operation of the banks in achieving this end, but in spite of appeals for caution in the granting of credit from October 1950 onwards, advances increased by £93 million between June 1949 and June 1952.

201. There were many reasons for the upsurge of demand for bank advances during this period. Import prices and export prices, particularly the price of wool, rose considerably, and wages were subsequently increased as a result of intensified competition for labour and general increases granted by the Court of Arbitration. Many controls over domestic spending, incomes, and prices, and over imports, were removed or relaxed. As costs rose, manufacturers and traders sought more accommodation from the banks. The prolonged waterfront dispute of 1951 also forced some industries to hold produce in store for a considerable time and increased the demand for finance from the banks. Moreover, there was a general tendency for all producers and traders to expand their businesses and increase their stocks to take advantage of the prevailing buoyant demand. Bank overdrafts were the cheapest and most convenient means of financing expansion. Finally, in the latter part of 1951 and early 1952, imports became available in unexpectedly large amounts, due to increased production overseas and to the closing of alternative markets by credit restraints and import controls. Without assistance from their banks, many traders could not pay for goods which they had expected to arrive over a long period in the future. In the interest of New Zealand's credit standing overseas, the banks were officially requested to provide such assistance.

202. The banks were able to expand their lending to such a considerable extent because they had large reserves of cash in 1949 which were maintained, despite their increased lending, by surpluses in the balance of payments between 1949 and 1951. However, by March 1952, after a substantial deficit in the balance of payments, their reserves had fallen to a relatively low level in relation to their customers' deposits, and restraint in lending had become necessary in their own interests.

203. Advances fell by about £50 million between April 1952 and April 1953, partly due to a more restrictive lending policy by the banks, but mainly due to a decline in the demand for advances, as traders reduced their excess stocks and the flow of imports was held back to some extent by a system of exchange allocation introduced in April 1952.

204. From August 1952, use was made of the power to vary the minimum reserve ratios, but until the second quarter of 1954 the banks were left with wide margins of free cash, so that no restraint on their lending capacity was imposed by this means.

205. The demand for bank credit began to increase again towards the end of 1953. At that time the banks were holding relatively high reserves in relation to their customers' deposits and to the minimum reserve requirements, and were therefore in a position to meet this demand. The overdraft limits granted, and later bank advances, began to rise.

206. The ratios were raised to 25 per cent and 12½ per cent in May 1954, and from then until February 1955 were varied to leave the banks with a fairly narrow margin of free cash as their reserves fell, due to a balance of payments deficit. The Reserve Bank's lending rate was also raised twice, reaching 4 per cent in November 1954. However, advances continued to rise, and by February 1955 were £36 million greater than they had been a year previously. Up till this time, borrowings from the Reserve Bank were small, and practically all confined to the Bank of New Zealand.

207. The banks were assisted in meeting a substantial drain of cash in March 1955 by special deposits by the Treasury and by a lowering of the reserve ratios to 15 per cent and 7½ per cent. From then until December 1955 the ratios were gradually raised to 24 per cent and 7½ per cent and the Reserve Bank's lending rate increased by three steps to 7 per cent. This forced three banks to borrow continuously from the Reserve Bank throughout 1955, and pay it £139,000 in interest between 1 April and 31 December. Some banks also borrowed in London or sold sterling assets to the Reserve Bank to maintain the required statutory balance. The interest paid or foregone by the banks was small in comparison with their increased interest earnings on the higher advances which they were now granting. But the Reserve Bank's policy towards the banks was certainly firmer than it had ever been in the past. It is impossible to say how far this firmer policy was responsible for the gradual downward trend of bank credit which occurred during the remainder of 1955; the banks' reserves of bankers' cash and overseas funds were, in any case, such as to induce them to adopt a relatively restrictive policy.

Overseas Transactions

208. As described in paragraph 162 above, the volume of money is increased in New Zealand when there is a surplus in the balance of payments and reduced when there is a deficit. Overall, New Zealand has had a substantial surplus in its balance of payments since 1935, and this has added a large amount to the volume of money. The trends in the balance of payments during the period are indicated in the following table which shows the effect of overseas transactions on the volume of money in the years concerned.

Effects of Changes in the Balance of Payments on the Volume of Money, 1935 to 1955

June Years	£ million
1935 to 1939	−36·5
1939 to 1947	+99·3
1947 to 1949	− 9·4
1949 to 1951	+43·3
1951 to 1952	−48·7
1952 to 1954	+64·6
1954 to 1955	−35·5

209. The causes of these changes in the balance of payments position are examined in Section Three of this report. A surplus in the balance of payments not only directly increases the volume of money, but also, by adding to the basic reserves of the trading banks, makes possible a multiple expansion of trading-bank credit. A deficit reduces bankers' cash and, unless the banks are holding excess cash reserves, forces them to reduce credit by a multiple of the reduction in their reserves. The expansion of bank advances which has occurred during the period which we have surveyed would not have been possible in the absence of the large additions which have been made to banks' reserves through surpluses in the balance of payments.

210. Overseas transactions also have other indirect effects on the volume of money in New Zealand. Even if overseas receipts and overseas payments remain in balance, a rise in export and import prices is likely, in the absence of State intervention, to lead to an increase in the volume of money. For those handling exportable or imported goods, or goods in the production of which exports or imports play a considerable part, are likely to require an increase in overdraft accommodation to cover increased costs. And if, as often happens, wages are increased as a result of the increases in incomes of primary producers and rises in the consumers' price index generated by price increases overseas, there will be a further general demand for advances to pay the extra wages. If the banks meet this higher demand, the volume of money will be correspondingly increased. Since 1935 export and import prices have increased by 300 per cent and 186 per cent respectively. In view of the large part which imports and exports play in the economy there is no doubt that these price increases have been an important cause of the expansion of bank advances and the volume of money since 1935. (A fall in export and import prices would, of course, have the opposite effect in the absence of State intervention.) Not only the prices, but also the quantities of exports and imports, have increased since 1935. The total value of external trade rose from £83 million in 1935 to £479 million in 1954. This being so, a large increase in bank advances to persons directly or indirectly involved in external trade was inevitable and essential. Whether, in fact, the increases in bank advances and in the supply of money which have taken place have been excessive is the subject of discussion in a later chapter.

211. The measures taken by the Government to attempt to counter some of the effects of rising overseas prices are considered in Section Five of this report and in Section Two of Appendix C.

New Zealand's Credit System

212. Any reasonably advanced economy, especially one based primarily on the institutions of private ownership and enterprise, requires a large volume of credit (and therefore debt). Credit is necessary to enable private individuals or firms to obtain the expensive buildings, equipment, and stocks necessary for modern production and sale; to facilitate the transfer of land and other assets from one person to another; and to enable individuals to obtain houses and household equipment and their local governments to obtain all the costly facilities necessary in an urban area, without waiting until they have saved sufficient from their own incomes to pay for them. The Central Government usually also chooses to borrow, although it has the power to finance all its requirements by

taxation or by requiring the Reserve Bank to issue new money to it. Excessive use of the latter method would result in disastrous inflation; and it is often more convenient and expedient for a Government to raise part of its requirements through a voluntary loan than to raise all by compulsory taxation.

213. In Appendix C we study in detail such information as can be obtained on changes in the indebtedness of the major borrowers in the New Zealand credit system and changes in the volume of credit granted by the major financial institutions which transfer to the borrowers the savings of persons or institutions who wish to put aside temporarily some part of their income. We also survey briefly the structure and operations of some of these institutions and of some of the bodies which have been set up to control the granting of credit. Here we shall merely summarise the main conclusions of the more detailed study.

Borrowing by the Government

214. The total indebtedness of the Government rose from £313 million in March 1934 to £731 million in March 1955, £281 million of the increase taking place between 1939 and 1946. However, between 1934 and 1955, its overseas debt fell from £174 million to £100 million. As a percentage of the country's export income, interest payments overseas fell from 13·3 per cent to 1·1 per cent during the same period. Interest paid on the total debt rose from £11·6 million to £20 million during the period; but as a percentage of the gross national income it fell from 9·1 per cent to 2·2 per cent.

215. The bulk of the public debt in New Zealand is held by Government-owned institutions, by savings banks and insurance companies, and by reserve accounts set up for the benefit of the primary industries. Interest payments on the debt, therefore, benefit, directly or indirectly, a very large number of people.

Borrowing by Local Bodies

216. The total indebtedness of local bodies fell from £78 million in March 1934 to £62 million in March 1950, and thereafter rose to £91 million in March 1955. Their overseas indebtedness has been continuously and substantially reduced – from £25 million in 1934 to just under £4 million in 1955. Interest payments on loans and overdrafts have declined markedly as a proportion of the total revenue of the local bodies – from nearly 25 per cent in 1934 to just over 5 per cent in 1955.

217. Recurrent difficulties have faced local bodies since 1951 in raising the finance required for their expanding works. A major reason for the difficulties faced by the local bodies would appear to be that the increases in interest rates approved for local body loans have not been in line with the increased returns available from other avenues of investment. As a consequence, the local bodies have not obtained as much as they would have wished from some of the institutions, especially the insurance companies to which they have traditionally looked for funds.

Private Borrowing

218. Information on borrowing by private individuals and firms is limited and we make suggestions later in this report as to statistics which might be collected and research which might be done in this field. A summary of the information which is available is to be found in Section Three of Appendix C, where there is an examination of the extent of borrowing by industrial and commercial firms, by farmers, by individuals requiring finance for housing, and by individuals requiring finance for various consumer goods.

The Sources of Credit

219. The table given in paragraph 250 of Appendix C gives some indication of the relative amounts of credit extended by major financial institutions and the changes which have taken place since 1934.

220. The following notable features are shown by the table:

(a) There has been a considerable expansion of lending by practically all the institutions, especially since 1950.

(b) Government-owned or Government-controlled institutions are responsible for a very large proportion of total lending and investment in New Zealand. The Reserve Bank, the Post Office Savings Bank (including national savings), the Government Superannuation Fund, the National Provident Fund, the Earthquake and War Damage Fund, the State Advances Corporation, and the Public Trust Office are all Government institutions; the Government has a voice in the disposal of the primary industry reserve accounts; it owns a trading bank which does 40 per cent of the advances and deposit business of the trading banks as a whole; and it also owns important life and fire insurance offices.

(c) The loans and investments of the trading banks are significantly less than the total of those of the institutions collecting small savings and, in most years, less than the total of the loans and investments of the institutions providing facilities for insurance and superannuation.

221. The importance of lending by the trading banks lies primarily in the fact that an expansion of their lending normally leads to an expansion of the supply of money. When other financial institutions expand their lending, the existing supply of money is not increased; part of the supply is transferred from one person, through the financial institutions, to another person. However, an expansion of the borrowing and lending activities of some of these other financial institutions does increase the volume of "near moneys" available to the community. For example, when there is an excess of lodgments over withdrawals in the Post Office or other savings banks, total savings bank deposits increase. This excess is nearly all lent by these savings banks, but no depositor forgoes his right to draw out deposits on demand.

222. The reason why an expansion of trading-bank deposits has greater economic significance than an expansion of savings-bank deposits is shown in the following table, which gives a rough indication of the extent to which the average amounts standing to the credit of customers at different savings institutions and at the trading banks are used during the year:

Turnover of Amounts Available to Customers in Various Financial Institutions, 1954–55

Institution	Amounts Available to Customers at 31 March 1954	Withdrawals in Year Ended March 1955	Ratio of Withdrawals to Amounts Available to Customers
	£ million	£ million	Per Cent
Post Office Savings Bank ..	205·9	112·8	55
Trustee savings banks	41·1	26·2	64
National Saving	65·5	10·3	16
Trading banks—			
Total deposits	282·3	4,577(1)	1,621
Total deposits as above plus unexercised overdraft authorities	385·8		1,186

(1) Value of debit transactions.

223. It can be seen that sums lodged in the savings banks tend to remain there for a relatively long period, e.g., the withdrawals from the Post Office Savings Bank during 1954–55 were equivalent to little more than one-half of the amounts to the credit of customers at the beginning of the year. On the other hand, withdrawals from the trading banks during the year were equivalent to over sixteen times the deposits standing to the credit of customers at the beginning of the year. Since cheques may be drawn against unexercised overdraft authorities, it perhaps gives a fairer comparison to include these unexercised authorities among the amounts available to customers; even then, withdrawals were nearly twelve times the amounts available to customers at the beginning of the year. Sums lodged in trading banks, therefore, are intended for use in the main in the near future, because trading banks are the channel through which day-to-day payments are made. In other words, a given amount of trading-bank deposits (and unexercised overdraft authorities), because it is turned over so rapidly, finances during a year a much greater volume of expenditure than does an equivalent amount of savings-bank deposits.

224. The structure and operation of the various institutions providing credit in New Zealand are more fully examined in Appendix C.

Interest Rates

225. Interest is the price which is paid for credit. If loan money becomes scarcer, rates of interest generally tend to rise; conversely, if loan money becomes more plentiful, they tend to fall. The rates of interest charged to different borrowers vary according to the lenders' assessment of the relative risks involved in lending, the relative costs involved in making the loans and collecting payments on them, and so on.

226. Since the Government is the major borrower in the credit system in New Zealand, changes in the rate of interest at which it can borrow give a broad indication of the relative ease or difficulty of obtaining loan money. Government public loan issues between the years 1922 and 1932 were made at rates of interest varying between 5 and 5½ per cent. The conversion loan of 1933 was made in the main at 4 per cent. Subsequent issues between the years 1934 and 1939 were made at 3½ per cent and

4 per cent. Soon after the outbreak of the second world war, the rate for long-term Government borrowing fell to 3 per cent, and continued at that figure until about 1950. Controls and shortages during the war and early post-war periods both held down effective demands for loan money and gave many people no alternative but to save large amounts of their expanding money incomes. In these circumstances it is not surprising that interest rates remained generally low.

227. After 1950, for reasons outlined previously, the demand for loan money rose substantially. So did the supply of money, but from 1952 onwards, the demand for loan money has tended to rise more rapidly than the supply, and interest rates generally have increased (e.g., the 1955 Government loan of £10 million was issued on terms which offered investors a return of nearly 4⅛ per cent together with tax concessions attractive to the larger investor, yet it was slightly undersubscribed). Mortgage rates have followed a similar rising trend.

228. Since 1941, trading-bank overdraft rates have been fixed by agreement between the Government and the trading banks at between 4 and 5 per cent. The average rate of interest earned by the banks in 1954–55 was £4 11s. 8d. as against an agreed maximum of £4 15s.

[NOTE.—In February 1956 the maximum and minimum limits were removed, and the banks were given discretion to fix interest rates for individual transactions, provided that the average return to the banks over all transactions did not exceed 5 per cent.]

The Government has also for many years maintained direct controls over the maximum rates which may be charged or paid for loans, or paid for deposits, by several types of institutions. For example, the rate of interest which local bodies may pay for loans is subject to regulation, and has been maintained at levels which have made it difficult for a number of local bodies in the last three or four years to raise adequate finance. Maximum rates payable on deposits made with the savings banks, local bodies, building and investment societies, and various trading companies are also controlled.

229. By maintaining the rates of interest charged by the State Advances Corporation at relatively low levels the Government has also exerted a restraining influence over the general level of interest rates on mortgages.

Control of Credit

230. These controls over interest rates have been accompanied by several measures designed to influence the demand for, or supply of, credit. The various controls imposed on trading-bank credit have been discussed earlier in this Section of the report. In addition, there has been control over issues of capital by companies since 1940. In 1952, because of heavy pressure on the credit market, a Capital Issues Committee was set up to administer the regulations, still in force in much the same form as during the war, except that issues of capital of less than £10,000 were exempted from control. After adopting a fairly strict policy in 1952, the Committee gradually increased the proportion of applications approved, so that only 16 per cent of applications were declined or deferred in 1954. However, in the first nine months of 1955 applications declined or deferred rose to 43 per cent of the total applications made.

231. The Government has controlled borrowing by local bodies since 1926, when the Local Government Loans Board was set up. In general, the Board does not appear, until fairly recently, to have reviewed loan proposals in relation to the complete investment programme, public and private, of the country. In 1955, however, the Minister of Finance directed the Board to have regard to the essentiality of the projects concerned, when considering applications to raise loans.

232. Finally, a measure of control over hire-purchase transactions was introduced in the 1955 Budget. Provision was made for minimum deposits and maximum periods for payment of the balance owing under hire-purchase agreements and credit-sales agreements.

233. After the examination of economic objectives and the historical review of the economy and of the monetary, banking, and credit systems in New Zealand covered in Sections Two, Three, and Four of this report, we now consider the special problems associated with inflation in New Zealand.

Section Five

INFLATION IN NEW ZEALAND

Introduction

234. The main inflationary forces at work in New Zealand during the last twenty-one years and the methods of combating inflation are examined in this section. By 1938 New Zealand had substantially emerged from the depression and had even begun to feel some inflationary pressure, as evidenced by her balance of payments crisis in 1938–39. This situation was commented upon in the 1939 Budget in which it was pointed out that *"the only permanent solution of the unemployed problem"* was *"for men to find work in productive industry"*. In the meantime, Government action in beginning works and subsidising an expansion of local body work had produced quick results in *"a rapid increase in consumer purchasing power"*. But, as the Financial Statement pointed out, *"in the absence of an equally rapid expansion in production"* this increase in consumer purchasing power had *"led to an increase in imports and a drain upon the sterling resources of the Dominion"*.

235. Within a matter of months the second world war was to add its own inflationary problems with production of consumer goods and services quite insufficient to match the purchasing power available for spending. As explained in *The New Zealand Economy, 1939 to 1951*, *"during the war, productive resources both in New Zealand and overseas were diverted to war purposes. Shortages of shipping further reduced imports for civilian consumption and there was some physical destruction of goods destined for New Zealand. On the other hand money incomes increased on account of the addition to the labour supply of more women and elderly people, long overtime hours, upgrading of workers, and high wage and salary rates. The need for Government spending for war purposes was immediate and urgent; production for civilian consumption was far below what people could buy with their higher money incomes. A variety of controls was therefore imposed to prevent the expanded demand from having its full effect in forcing up prices"*.

236. With the end of the war, conditions altered again. The pent-up wartime demand for goods and the need for capital works which had been delayed by the war began to make themselves felt. The gradual removal of controls, when it began, allowed these pressures to cause higher prices. The Korean War and the associated boom in raw material prices, especially wool prices, brought substantial increases in incomes and prices in New Zealand. Because of the special circumstances arising from the war, attention naturally focuses itself chiefly on the ten years since 1945.

The Nature of Inflation

237. Inflation is an expansionary condition of the economy in which prices, incomes, public and private expenditure, and bank credit tend to influence one another in an upward direction. The inflationary process

may begin as a result of either external or internal factors. An essential part of the inflationary process is excessive demand for goods and services at current prices.

238. The basic problem which inflation presents is to keep within reasonable bounds the total demand for goods and services, both locally produced and imported. Inflation usually reveals itself through rising prices, through a greater demand for imports than current earnings of overseas exchange will meet, and through more employment vacancies than can be filled.

239. Because a very large part of our national income is directly and indirectly dependent on prices realised in overseas markets, and because imports form such a substantial proportion of our available goods and services, overseas factors exercise an important and at times even a dominant inflationary or deflationary effect on the New Zealand economy.

Apparent Attractions of Moderate Inflation

240. Despite the very serious damage done by inflation, which we discuss below, it cannot be denied that moderate inflation has certain attractive features. A sellers' market means that goods and services are easy to sell at rising prices. On paper, business profits rise faster than costs. The money value of fixed assets such as land, buildings, and industrial equipment tends to rise, and thus to provide further security for borrowing by way of bank overdraft or otherwise.

241. There is the general feeling of prosperity given by higher wages, salaries, and other incomes. People lose the fear of unemployment and Governments are relieved of responsibility for seeing that unemployment does not arise. "Balancing" both Government and private budgets is made easy by buoyant revenues.

242. All debtors benefit from inflation because the real burden of debts (including the public debt and private mortgages and other forms of private debt) is reduced. Interest and repayment charges are paid in money which pound for pound is worth less in terms of real goods and services than the amount originally borrowed.

Damage Done by Inflation

243. These apparent advantages of moderate inflation are heavily outweighed by the damage done to the economy by the continued existence of inflationary conditions.

244. Inflation brings a serious distortion in the distribution of incomes. Those whose incomes are relatively fixed in terms of money are, in effect, subject to an insidious but nevertheless real form of taxation and a loss of real income.

245. The expansion of money incomes encourages personal spending and stimulates business expansion beyond the point permitted by available physical resources and the labour force. Such conditions lead to upward pressure on the prices of consumer goods and to strong competition for labour. The result is a cumulative tendency for costs, prices, and wages to rise. Particularly in New Zealand's circumstances, the pressure on internal prices is accompanied by an increased demand for imports.

246. The real value of savings, and the incentive to save, are both reduced as the value of money falls. Discouragement of saving is all the more serious when it is associated with a strong demand for private and public capital investment. When this happens there is an inadequate performance of the economic function of saving, which is to withdraw from the stream of purchasing power available for spending on consumer goods and services an amount equivalent to the purchasing power distributed through capital expenditure. This aspect of inflation is referred to later in this section of the report. **We are satisfied that failure to achieve this balance between private and public savings on the one hand and capital investment on the other hand lies at the root of our inflationary problem.**

247. Under inflationary conditions the ability of export industries to compete in overseas markets is impaired, and so is the ability of local industries to meet overseas competition. In New Zealand, inflation is bound to cause balance of payments difficulties, including difficulty in maintaining reserves of overseas exchange.

248. Earlier we referred to the reduction in the real burden of debts brought about by inflation. This feature of inflation has another side, in that long-term contracts in terms of money are falsified. This is a most serious aspect, which of itself is sufficient to demand the avoidance of inflation as far as is humanly possible.

Changes in the Purchasing Power of the New Zealand Pound Compared with the United Kingdom and Australia

249. The following table shows the changes in purchasing power of the New Zealand pound, the United Kingdom pound, and the Australian pound since the period 1926–30, which is commonly selected as a statistical base because of the relatively stable economic conditions in those years:

Purchasing Power Compared With 20s. in 1926–30

Calendar Year	New Zealand Pound	United Kingdom Pound	Australian Pound
	s. d.	s. d.	s. d.
1930	20 5	21 2	20 8
1935	23 11	23 0	24 2
1940	19 4	17 8	21 0
1945	17 1	16 1	17 10
1950	14 2	14 1	12 11
Quarter ended—			
1955—December	10 7	10 9	8 3

250. While a fall in purchasing power of the New Zealand pound from 20s. in 1926–30 to 10s. 7d. in 1955 appears very considerable, it should not be overlooked that the New Zealand pound has lost practically no more in purchasing power than the money of her main customer, the United Kingdom. In view of the very great influence of external trade on the New Zealand economy, the purchasing power of the New Zealand pound in comparison with that of the United Kingdom and Australia must be regarded as reasonably satisfactory.

251. Another indication of the extent to which prices have risen since the depression in New Zealand is to be found in the increase in the gross national income between 1934–35 and 1954–55. Measured in money terms the gross national income is seven times as great as it was twenty years ago; but, corrected for price changes (i.e., roughly adjusted to the lower buying power of today's pound) it is only three times as great.

The Main Causes of Inflation

252. The main causes of inflation operating in New Zealand during the last twenty years emerge from the historical review contained in Section Three of this report, as:

(a) Rising overseas prices for New Zealand exports and imports.
(b) High private and Government capital expenditure.
(c) Government expenditure on war and other military requirements.
(d) Inadequacy of voluntary savings to match increased capital investment.
(e) Expansion of the money supply through increases in Reserve Bank and trading-bank advances.
(f) Wage and salary increases.
(g) The comparatively rapid population increase in the post-war years.
(h) Increased Government expenditure on social services and the philosophy and policies commonly associated with the Welfare State.

Overseas Prices

253. The general trend of overseas prices since 1934 has been upwards. The following table shows the increases at five-yearly intervals to 1950, and thereafter each year:

(Base: 1954 = 100)

Calendar Year	Index of Import Prices	Index of Export Prices
1935	35	25
1940	43	36
1945	62	44
1950	84	92
1951	98	108
1952	107	87
1953	101	97
1954	100	100
Quarter ended—		
1955—June	100	100

254. Higher prices overseas mean, of course, higher prices within New Zealand for goods bought overseas, and higher costs for goods and services in New Zealand which are dependent on imported equipment or materials. (Rising prices for imports have brought a higher turnover in money to traders and, therefore, if the percentage of profit on transactions remains the same, have yielded higher profits.) Through their effect on the consumers' price index, these higher import prices also afford grounds for claims for higher wages through general wage orders, new awards and agreements, and in private wage negotiations.

255. In 1934–35 total payments for imports were £33 million or approximately 25 per cent of the gross national income. In 1954–55 payments for imports were £253 million or 27 per cent of the gross national income. Where imports represent a very high proportion of total goods and services available, changes in import prices must exercise a powerful influence on the New Zealand price level.

256. As the above table shows, over the last twenty years New Zealand's export prices have risen more rapidly than import prices. Notwithstanding this considerable improvement in our terms of trade with the rest of the world, we have at several times since 1935, and especially during the last two years, spent on imports and other external payments substantially more than our greatly expanded external income, with a consequent reduction in our reserves of overseas exchange. Such a development is a definite indication of the presence of excessive internal demand.

257. Except for the operation from time to time of factors such as the guaranteed price in the dairy industry, the farm industry stabilisation accounts, the wool retention scheme, or the lowering of the exchange rate, increases in export prices are directly reflected in incomes in New Zealand. During the war the stabilisation accounts exercised a powerful restraining force on farm incomes, and the wool retention scheme —begun in 1950—countered some of the effects of the wool boom. In general, however, and apart from the effect of the stabilisation schemes, the influence of higher export prices on the New Zealand economy has been inflationary. An expansion of farm incomes is certain to be followed by a diffusion of higher incomes throughout the whole economy. It is true that higher export incomes provide the overseas funds to pay for more imports, but there is usually a time lag before the arrival of a higher volume of imports. Through the indirect expansion of other incomes and stimulation of economic activity generally, total expansion of incomes following an increase in farm incomes is apt to lead to a greater demand for imports than can be satisfied from the enhanced overseas earnings. This was the experience after the wool boom, and in the last twenty years a similar sequence of events has occurred several times.

258. During the war period particularly, and again as an immediate result of the wool boom, New Zealand experienced substantial surpluses of export and other overseas receipts over imports and other overseas payments. During the war these surpluses arose because, while New Zealand exports were well maintained and even increased, imports of goods for civilian consumption were greatly restricted. The shortage of imports arose mainly because, in the United Kingdom and other countries, industrial capacity had been diverted to war purposes. In these circumstances, the purchasing power distributed in New Zealand through export incomes was greater than the purchasing power absorbed by the goods and services imported.

Private and Government Investment Programmes

259. Especially in the post-war period the high and increasing levels of private and, to a lesser extent, Government capital investment programmes have exercised a powerful inflationary influence. The proportion of the gross national income devoted to private capital investment

(excluding increases in trading stocks) has risen from 7 per cent in 1937–38 and in 1938–39 to 14 per cent in 1954–55. For the year 1954–55 the ratio of Government (including local authority) investment to gross national income was 9 per cent compared with 8 per cent in 1937–38 and 10 per cent in 1938–39.

260. In our historical survey we have referred to the great growth of activity in the building industry. The very substantial proportion of capital investment made up of expenditure on building is shown by the following table:

Year Ended March	Dwellings	Other Building	Total Building	Total Gross Capital Investment (Excluding Changes in Stocks)	Percentage of Building to Total Gross Capital Investment
	£ million	£ million	£ million	£ million	
1952 ..	28	31	59	148	40
1953 ..	28	33	61	174	35
1954 ..	32	39	71	184	39
1955 ..	40	51	91	211	43

261. The attempting of a greater volume of work than can be carried out economically with the available resources of manpower, material, and equipment, has been manifest in the building industry throughout the post-war period. As a result there has been a constant upward pressure on prices and wages in the industry, and this has also exercised a strong inflationary influence on other sectors of the economy.

262. The effects of capital expenditure on the economy were not understood by some of the witnesses appearing before us. The special importance of capital expenditures as a cause of inflation arises from the fact that capital works employ men, use materials and equipment and involve the expenditure of overseas exchange. In this way they diminish the pool of labour and other resources available for local production and the exchange available to pay for consumer goods and services from overseas. While capital works are in progress they distribute purchasing power in the form of wages, salaries, profits, interest, and other incomes, but not until the projects are well advanced or completed do they produce consumer goods and services. It is when the total volume of investment in relation to the gross national income is expanding or is maintained for a period at a relatively high level, as it has been over the last four years, that strong inflationary pressures are generated.

263. To cite a well-known example, the Roxburgh Hydro-electric Scheme is expected to cost in total about £23 million, a very substantial part of which will represent wages and other similar payments. But, until the generators are in operation and the project is supplying electric power to the South Island network, the scheme will provide no consumer goods and services to match the incomes being distributed. When the scheme is in operation, there will be a substantial addition to electric-power supply in the South Island. Similarly, a large capital work may require heavy expenditure of overseas funds. In the meantime, the export incomes distributed to farmers and others cannot be matched by

imports of consumer goods without drawing on reserves of overseas exchange. The Murupara Pulp and Paper Scheme is another example of capital expenditure involving heavy diversion of manpower, materials, and overseas exchange during the course of construction. Later, an important contribution in the form of increased production for export and local consumption is expected to result.

264. From these examples it is clear that, while capital works are in course of construction, incomes are distributed without a corresponding supply of consumer goods and services. Although we have quoted the Roxburgh Hydro-electric Scheme, which is a notable example from the public sector, it should not be overlooked that, in comparison with the immediate pre-war years, it is in the private sector that capital investment has proportionately shown much greater and more rapid growth.

265. The effect on the economy of increased investment, especially during the last few years, has been an expansion of incomes relative to the supply of consumer goods and services, leading to a situation where everything that can be produced or imported can be sold readily. Vacancies for employment, at increasing rates of remuneration, exist for far more workers than are available, and there has been a greater demand for imports than could be paid for from current export earnings. As we point out later, a higher capital investment gives rise to the need for increased voluntary savings or higher taxation to remove surplus purchasing power and thus reduce the current demand for locally produced and imported consumer goods and services. Capital investment may be expected to continue at a high level and the need for increased savings and higher taxation is, therefore, also likely to continue.

Increased Government Expenditure

266. During the war, expenditure by the Government for war purposes had much the same effect on the economy as a capital works programme, except that war expenditure does not usually improve the productive capacity of the country. In principle the process is similar, in that resources of manpower, materials, industrial equipment, and overseas exchange are diverted to war purposes. At the same time as personal incomes are expanded by Government expenditure on war, the production and importation of goods and services for civilian consumption are contracted, and there is a tendency for demand to exceed supply and for prices to increase.

267. The effects of expanded Government expenditure on social services are dealt with more fully later. As is the case with capital expenditure and war expenditure any inflationary effects can be offset to some extent if the expenditures are financed from taxation. During the war, particularly, it was not found practicable for the whole of Government current expenditure to be financed from taxation, and the result was a very large deficit on current account in the Government's transactions. Such a deficit, which reached a peak of £69 million in 1943–44, means that money is being paid out by the Government, and people are receiving incomes which are not matched by production of consumer goods and services. This process is, of course, highly inflationary and it was one of the main causes of wartime inflationary pressures in New Zealand. As we have pointed out in our historical review, in comparison

with other countries engaged in warfare, New Zealand was relatively successful in avoiding this cause of inflation and in minimising its effects on the price level during the war period.

Expansion of the Money Supply Through Reserve Bank and Trading-bank Credit

268. We have already mentioned in our historical review how an expansion of Reserve Bank credit by the Government was partly responsible for an inflationary situation in 1938 and 1939. Use of Reserve Bank credit is another example of the distribution of purchasing power by the Government through its expenditure, without any increase in the supply of goods and services becoming available, and without any surrender of purchasing power such as occurs when expenditure is financed from taxation or by borrowing from the public. When the labour force is fully employed, financing of Government expenditure from Reserve Bank credit is highly inflationary.

269. Apart from direct inflationary effects, expenditure by the Government from Reserve Bank credit may have indirect effects. When the Government spends money provided by the Reserve Bank, the recipients of consequential payments lodge the Government cheques to the credit of their accounts at the trading banks. The trading banks clear these cheques through the Reserve Bank and, as a result, their balances at the Reserve Bank are increased. Unless the reserve ratio is promptly and appropriately adjusted, the increase in these balances may become the basis for an expansion of trading-bank advances considerably greater than the original spending by the Government from Reserve Bank credit.

270. Taking the last twenty years as a whole, we do not consider that the use of Reserve Bank credit has been a major direct cause of inflation, but on several occasions in the post-war period greater restraint in its use by the Government would have been very beneficial, especially having regard to the effects of the use of Reserve Bank credit in expanding the lending capacity of the trading banks.

271. Trading-bank advances and discounts have risen from £44·6 million at March 1935 to £189·3 million at March 1955. Nevertheless, we do not regard the increase of bank advances as having been one of the chief initiating causes of inflation throughout the greater part of the period which we are considering.

272. As a general rule, a rise in the level of trading-bank advances takes place as a consequence of other inflationary factors, in particular as a result of higher export and import prices and the rises in incomes and costs which come in their wake. Such a rise in advances contributes in its turn to the inflationary process by enabling the existing higher demand for capital and consumer goods and services to be made effective. In some instances, bank credit has been used to finance capital expenditure directly.

273. Higher trading-bank credit was an important factor in the excessive spending which followed the wool boom of 1950–51, and which culminated in the introduction of exchange allocation in 1952. Similarly, a large increase in trading-bank advances was a major contributory factor to the excessive spending and balance of payments deficits which took place throughout 1954 and 1955.

274. It is clear that restriction of the level of trading-bank advances is one of the most effective restraints which can be exercised in an inflationary situation.

275. Nevertheless, as we have already stated in respect of trading-bank advances, we do not regard expansion of the money supply as one of the main initiating causes of inflation over the last twenty years. In many instances we consider that expansions in the money supply have been the result of other developments such as expanding export incomes, rising import prices, wage increases, and so on.

276. An increase in the volume of money is important, however, because it means that individuals, firms and public authorities have more spending power available to them. They can therefore afford to buy more goods and services at current prices (if the country has the resources to produce or import them), or they can then pay higher prices, wages, rents, or rates of interest than those now ruling. But, by itself, an increase in the volume of money does not fully account for the development of an inflationary trend. As we have seen, a change in the volume of money may itself be an effect of changes in prices, production, imports, or employment. Moreover, in any consideration of the impact of money on the economic system, the speed with which money is spent is at least as important as the volume of money in existence.

Velocity of Circulation of Money

277. That the speed with which money is spent may vary considerably is indicated by the following table, which shows changes in the velocity of circulation or turnover of trading-bank deposits for the years 1936 to 1955:

Index of Velocity of Circulation of Trading-bank Deposits: Average of Monthly Index for March Years

(Base: Year ended March 1939 = 100)

Year ended March:		Year ended March:	
1936	100·8	1946	52·6
1937	104·3	1947	60·9
1938	102·7	1948	58·7
1939	100·0	1949	57·7
1940	88·6	1950	64·8
1941	76·9	1951	69·7
1942	69·5	1952	69·3
1943	58·3	1953	65·8
1944	54·4	1954	70·7
1945	49·8	1955	69·7

278. The speed at which bank deposits were turned over declined during the war, the velocity of circulation in 1945 being about 50 per cent below the 1939 figure. This was the result of a large increase in the volume of bank deposits, due mainly to surpluses in the balance of payments and to Government borrowing from the banking system, accompanied by limited opportunities for spending money either on consumer or capital goods. There has naturally been some increase in the velocity of circulation since the war, but, even in 1955, it was still about 30 per cent less than it was in the years immediately preceding the war.

279. Thus the decisions of those who have money as to how rapidly they will spend it are at least as important to the economy as the volume of money in existence.

Wage and Salary Increases

280. We consider that wage increases have contributed to the inflationary process both directly and indirectly during the last twenty years, but in general they have been the result of other and more fundamental inflationary forces such as buoyant export incomes and rising import prices. We refer in Section Three of this report to the tendency in the post-war years for the margin of actual wages paid over award rates to progressively widen, and to the recent great acceleration of the process. This development is, of course, a very definite indication of inflationary pressures because it means that increased wages are being sought and conceded in the confident expectation that the increased payments can be added to prices, together with an appropriate profit margin. Since wages are a very important constituent of costs, it is manifest that, while such conditions continue, it is impossible to expect stability in prices of locally produced consumer goods and services.

281. When a general order increasing wages is made under conditions of over-full employment, the amounts paid in industry to maintain margins well above award rates are much more significant than the direct and necessary legal effects of the wage order. These amounts paid to maintain margins over award rates are, of course, added to prices together with a margin of profit.

Comparatively Rapid Population Increase

282. In our historical survey we pointed out the relatively rapid rate of population increase in the post-war period resulting from natural increase and, at times, from immigration. A rapid population increase gives rise to an accelerated demand for capital expenditure on houses, schools, hospitals, transport facilities, industrial buildings and equipment, and other similar purposes, and this tends to add to inflationary pressures.

Social Services and the "Welfare State"

283. The inflationary influence of increased Government expenditure on social services and the influence of the Welfare State are discussed in the next section of this report.

Measures to Combat Inflation

284. When factors such as those mentioned above are combining and inter-acting to generate inflationary pressures the basic problem of economic policy is to keep the total demand for resources within reasonable bounds. A number of factors which help to keep or bring the level of demand closer to the supply of goods and services becoming available are now discussed.

Higher Production

285. The best remedy for inflation is a higher level of production of consumer goods and services, provided it can be achieved without a disproportionate expansion of income such as occurs when there is a

general increase in overtime at high penal rates of pay. As a supplement to local production, higher imports of consumer goods can make a contribution towards stability. However, in the absence of overseas borrowing, a higher level of imports is likely to exhaust reserves of overseas currency, and the use of import surpluses as a deflationary device is limited by the extent to which reserves or borrowings can safely be used for the purpose.

Savings

286. We have pointed out that higher public or private capital expenditure results in the payment of large sums in salaries, wages, and other incomes, without in the meantime providing consumer goods and services on which these incomes may be spent. This is a highly inflationary process unless it can be offset by reduced spending on the part of the public, thereby reducing demand for the current supply of goods and services. When capital expenditure is increased, inflationary pressures will be generated unless the flow of voluntary savings keeps pace, or the Government withdraws more purchasing power from the public.

287. The inflationary effects of the growing capital expenditure and other factors would have been much less pronounced if it had been possible in the post-war years to maintain the proportion of small savings, or other private saving, to the gross national income, at a level nearer to the wartime level, or even to the 1935 level.

Primary Industry Reserve Accounts

288. These accounts were a special device used during the war and post-war years to ensure that the buoyant export incomes did not exert the full pressure of demand on the depleted supplies of consumer goods and services. The annual accumulations in these accounts were similar in their economic effect to an excess of deposits over withdrawals in the Post Office Savings Bank. In the main the primary industry reserves were invested in Government securities and the proceeds were used to finance Government capital expenditure. In the absence of these accumulations in the industry accounts, the inflationary effects arising from increased Government expenditure on war and capital development would have been much greater.

Wool Retention Scheme

289. The Commission commends this scheme as both timely and appropriate to the circumstances of the boom in wool prices of 1950–51. Under the scheme, the wool growers and the Government both agreed to forego temporarily their respective shares of some £32 million of the very high prices received for wool. The effect of spreading the return to the grower over a period of five years enabled many farmers to carry out an orderly programme of development which, if it had all been attempted in 1951, would have been beyond the labour and other resources available. There was, of course, a benefit to the farmer in that lower tax rates applied in later years when the funds were released and many would also benefit because their relatively lower incomes in the years following 1951 would place them in lower taxation brackets than in 1951.

290. Under the wool retention scheme, in contrast with the primary industry reserve accounts, the amounts retained were not invested in Government loans, but were held in special retention accounts at the trading banks. The scheme, however, did not include any provision to prevent expansions of trading-bank advances based on the accretions which occurred to the balances of the trading banks at the Reserve Bank. We think this aspect should receive attention in any future scheme of this nature.

Restraint on Trading-bank Lending

291. This subject is dealt with extensively elsewhere in the report. The over-generous granting and use of bank credit contribute to an inflationary situation by making the process of financing higher wage payments and holding stocks of a higher money value relatively easy. If finance for these and other similar purposes is scarce, an expansion of private investment like that which has occurred in recent years is much more difficult to carry out. Restraint on bank credit alone cannot be expected to right an inflationary situation, but applied early enough and firmly enough it can act as a powerful reinforcement of fiscal and other policies designed to achieve that end.

Taxation and Government Borrowing

292. Higher taxation is one recognised means of reducing the volume of purchasing power in the hands of the public. Provided the increased taxation is not used for increased Government expenditure but leads to a Government overall surplus, there are circumstances in which this method can be most effective. A surplus so achieved would be appropriately applied to reduction of the Government's indebtedness to the Reserve Bank. It is important, however, that any policy of budgeting for a surplus through higher taxation should be supported by strict control of bank advances and by appropriate interest-rate policy, otherwise increases in taxation may be reflected, at least in part, in higher prices. In other words the inflationary process could be stimulated and not curbed.

293. A Government surplus achieved by reducing expenditure is, of course, likely to be more effective in curbing inflation because in that case there will be a reduction of purchasing power in the hands of the public and no added impetus to inflation from higher taxes.

294. Notwithstanding the reservation we have made that in an inflationary situation higher taxes may be reflected in higher prices, we are firmly of the opinion that budgeting for a substantial surplus, through higher taxation if necessary, is an essential part of any comprehensive policy of curbing inflation. We believe that in inflationary circumstances the Government should finance from taxation as high a proportion as possible of its total expenditure, including capital expenditure. From the point of view of countering inflation we would suggest the following order of preference for sources of finance for Government expenditure (including works and other capital expenditure):

(a) Taxation.
(b) Borrowing in New Zealand.
(c) Borrowing overseas.

295. Financing capital works from taxation is more likely to reduce current expenditure on consumption of consumer goods and services than is borrowing from the public in New Zealand. Nevertheless, we consider that, in existing circumstances, the Government is fully justified in borrowing on the market in New Zealand to the fullest extent practicable, even if as we suggested previously, any overall cash surplus is devoted to reduction of Government indebtedness to the Reserve Bank. This we regard as highly desirable in inflationary circumstances. Competition by the Government for the money available on the market is one means of putting a brake on too rapid expansion in other sectors of the economy and especially in the private sector.

296. Borrowing overseas is justifiable when the level of capital development is so high that it is necessary to augment the resources of overseas exchange becoming available. In this way, overseas borrowing can make a useful contribution by enabling the level of consumer imports to be maintained. However, Government overseas borrowing should not be made a substitute for a withdrawal of purchasing power through taxation and borrowing in New Zealand, when the condition of the economy indicates the need for such a withdrawal.

297. We have not included the financing of Government works from accumulated cash balances or from Reserve Bank or trading-bank credit in the above order of preference because they are directly inflationary in character and they should be avoided unless it is desired to apply a stimulus to the economy. In other words, these methods of finance are more appropriate to depression conditions.

298. In the foregoing paragraphs we have laid special emphasis on the importance of taxation as an anti-inflationary measure. We think that much of the popular objection to such measures stems from a misunderstanding of basic economic processes and of the economic function of taxation. In the modern State it should be recognised that a basic function of taxation should be to control the amount of purchasing power in the hands of the public and to reduce it when purchasing power is in excess of the desirable level. We believe that in inflationary circumstances the principal means of dealing with excess purchasing power should be higher taxation, supplemented by:

(a) A close check on public expenditure.
(b) A tight bank advances policy.
(c) Higher interest rates.
(d) Continued control on the level of private investment through existing controls.
(e) Appropriate adjustments of any arrangement for granting special depreciation allowances. Such allowances tend to accelerate capital expenditure and their withdrawal would remove an incentive to such expenditure.

Exchange Rate Policy

299. Only one general alteration in the New Zealand exchange rate has taken place during the last twenty years. This occurred in 1948 when the New Zealand pound was appreciated from £(N.Z.)125 = £(U.K.)100 to parity with the United Kingdom pound. This adjustment had important disinflationary effects because it curbed effects of increases in export prices and also prevented much of the rapid increase in import prices from being reflected in New Zealand prices.

300. A general alteration in the exchange rate results in an adjustment of farm incomes and of import prices. It so happened that the particular circumstances of 1948, when substantial additions were accruing to stabilisation funds for meat and dairy produce and when both import and export prices in terms of overseas currency were rising rapidly, enabled the exchange adjustment to be accomplished with the maximum beneficial effect and with a minimum of disturbance to the economy.

301. Major alterations in the exchange rate are a drastic and far-reaching method of adjusting the economy to external circumstances, through a redistribution of incomes in New Zealand. Although the immediate effects of an exchange adjustment are apparent, the final incidence of the alteration upon the different sections of the community is most difficult to measure. For example, much of any gain to the farmers from an exchange depreciation will be offset by rising import costs in terms of New Zealand currency and even by consequent increased costs in New Zealand. Similarly, the immediate loss of export incomes following an appreciation in the exchange rate will be compensated for, in part at least, by lower or less steeply rising import costs and also by lower or less steeply rising internal costs.

302. Although exchange adjustments do have important immediate effects in redistributing incomes in New Zealand, such adjustments do not affect the real national income, which comprises the goods and services available during the year to the community. The real national income can be raised only by an increase in production in New Zealand, or by an improvement in the terms of our overseas trade which enables us to import more in exchange for a given quantity of exports.

303. Because of the very far-reaching and disturbing effects on incomes and prices in New Zealand we think it better that major adjustments of this nature should be reserved for very special circumstances, such as those which occurred in 1933 and in 1948.

Interest Rates

304. The need to make greater use of interest-rate policy to reinforce other monetary and fiscal measures is discussed fully later in this report.

Direct and Indirect Controls

305. One method of dealing with inflationary pressures during the last twenty years has been to control directly the effects of inflationary pressures on prices, wages, profits, imports, and so on. The New Zealand experience has been that a comprehensive system of direct controls is very effective under wartime conditions, when operation of the controls is reinforced by patriotic motives and by special wartime fiscal measures. In peacetime any really comprehensive system of direct controls would be unlikely to receive wide public acceptance.

306. In a peacetime economy, tendencies towards inflation are best countered by a comprehensive combination of fiscal and monetary policies. Neither fiscal nor monetary policies are likely to succeed unless they both form part of a carefully concerted overall economic policy. But general economic policies, as with wartime control measures, are dependent to a considerable degree for their effectiveness on public understanding of the need for them. This understanding can only be achieved if the Government is prepared to provide adequate, clear, and objective information.

307. Application of moderate measures at an early stage may avoid the need for drastic measures later. The need for such early action is not always obvious and, if public understanding is to be achieved, the fullest public explanation of policy measures is necessary. It is relatively easy for the public to understand and appreciate measures designed to avoid a slump. Anti-inflationary measures are less likely to be understood or to be welcomed because they usually involve reducing someone's income or preventing someone from carrying out projects which to that individual appear advantageous but which, from the point of view of the community, should be postponed or even abandoned in the interests of economic stability and of making the best immediate use of available manpower, materials, and other resources.

308. Under modern conditions the Government must assume an increasing degree of responsibility for the general management of the economy. To do this successfully requires an objective outlook on the part of the Government and on the part of the public. We fully realise the difficulty in reaching and maintaining such a viewpoint when the interval between general elections and the period between appeals to the electorate are as brief as three years. It is not within our province to make recommendations about parliamentary elections, but we consider that, if the parliamentary term were longer, there would be sufficient time for the effects of longer-term monetary and other economic policies to become apparent.

309. Whatever the parliamentary term, we are satisfied that, if the modern economic system is to operate satisfactorily, the Government of the day must be prepared to take measures to some extent detrimental to short-term individual and political interests, but which are for the benefit of the country. It is only by such measures that the modern Welfare State can be managed satisfactorily and a reasonable measure of stability achieved.

Summary

310. The following is a summary of the more important matters dealt with in this Section of our report:

(a) Inflation is an expansionary condition of the economy in which prices, incomes, public and private expenditure, and bank credit all tend to influence one another in an upward direction.

(b) The apparent attractions of continued moderate inflation are heavily outweighed by the damage it does to the economy.

(c) Compared with a value of 20s. in the base years 1926–30, the retail purchasing power of the New Zealand pound was 10s. 7d. in the last quarter of 1955. Similar computations for the United Kingdom pound and the Australian pound show a 1955 purchasing power of 10s. 9d. and 8s. 3d. respectively.

(d) The main causes of inflation operating in New Zealand during the years 1935 to 1955 have been:

(i) Rising overseas prices for New Zealand exports and imports.

(ii) High private and Government capital expenditure.

(iii) Government expenditure on war and other military requirements.

(iv) Inadequacy of voluntary savings to match capital investment.

(v) Expansion of the money supply through increases in Reserve Bank and trading-bank advances.

(vi) Wage and salary increases.

(vii) The comparatively rapid population increase in the post-war years.

(viii) Increased Government expenditure on social services and the philosophy and policies commonly associated with the Welfare State.

(e) Apart from the drastic measures adopted during the war the more important means of combating inflation are:

(i) Higher production.

(ii) Increased savings.

(iii) Restraint on trading-bank lending.

(iv) Higher taxation and borrowing in New Zealand and in some circumstances borrowing overseas.

(v) Higher interest rates.

(vi) In special circumstances, arrangements like the primary industry reserve accounts and the wool retention scheme.

(vii) In special circumstances, an appropriate adjustment of the exchange rate.

(f) In a peacetime economy, tendencies towards inflation are best countered by a comprehensive combination of fiscal, monetary, and other economic policies, which for their effective operation are dependent to a considerable degree on public understanding of the need for them.

311. In the next section some of the effects of the Welfare State on the economy are examined.

Section Six

THE WELFARE STATE AND ITS EFFECTS ON THE ECONOMY

Introduction

312. When falling export prices brought the world depression to New Zealand in the 1930's, Governments for fifty years had gradually been assuming on behalf of the community a degree of responsibility for the welfare of the individual. The immediate result of the depression was to extend this responsibility to provision for the relief of unemployment. The experiences of the depression gave a fresh impetus to social reform, and the advent of a new Government in 1935 was quickly followed by Government acceptance of a much wider responsibility.

313. This acceptance of wider responsibility for individual welfare is the basis of the philosophy of the Welfare State. The widespread influence of some of the reforms introduced in New Zealand is indicated by this International Labour Office comment to the Geneva Conference of 1949 in a document entitled "Systems of Social Security": *"It* (N.Z.'s Social Security Act of 1938) *more than any other law has determined the practical meaning of social security and it has deeply influenced the course of legislation in other countries".*

314. The purpose of the Social Security Act, as set out in its preamble, is *"to safeguard the people of New Zealand from disabilities arising from age, sickness, widowhood, orphanhood, unemployment, or other exceptional conditions";* to provide medical and hospital treatment to all in need of it; and to provide *"such other benefits as may be necessary to maintain and promote the health and general welfare of the community".*

Redistribution of the National Income

315. The simple alleviation of distress, or prevention of undue hardship, by expenditure from State funds, which was the earlier conception, is no longer the sole aim. The Welfare State achieves some of its purposes through a calculated redistribution of the national income.

316. This redistribution is not confined to payments to the sick, the aged, and the needy, or to assistance to those who may be unemployed. For example, subsidies are used to keep down some prices which affect the cost of living, and the family allowance assists those with young families. In both these instances there is no means test; therefore the whole community shares the assistance, irrespective of income. In other instances, such as the age benefit, a means test is applied.

317. Government assistance towards the cost of housing is another method of redistributing the national income. The 1937 Financial Statement contains this comment: *"A more just distribution of the national income is linked up with the provision of adequate housing facilities"*.

318. Not all this redistribution is accomplished through the Social Security Fund. Family allowances are paid through the Fund, but subsidies are not. Nor is Government-assisted housing or State housing financed through it. And the Social Security Fund itself is augmented each year from the Consolidated Fund.

319. Indeed, because the contributions are not invested and accumulated for the future payment of benefits, the Social Security Fund is not a "fund" in the actuarial sense of that term. Rather, it is an account recording taxation collected and payments distributed according to a recognised but changing pattern of benefits.

Greater Scope of Government Action

320. The enlargement of Government responsibility under the Welfare State has been accompanied by widened scope of Government action. The Government controls the Reserve Bank, which is charged with the duty of using credit policy to promote and maintain economic and social welfare, stability of internal prices, and production. It is charged too with the duty of safeguarding the country's reserves of overseas funds.

321. The Government has, of course, also concerned itself with hours and conditions of work and minimum rates of pay since the last century. Here again, there has been a gradual enlargement of objective and action to include a wide improvement in conditions and increased leisure for all.

322. All these responsibilities involve the Government in a much more deliberate and comprehensive management of the national economy than was contemplated, or possible, under the more limited powers of democratic governments of the past. It is difficult to decide exactly where the Welfare State (as such) begins or ends and it is, therefore, also difficult to isolate its effects on the economy and to distinguish them from effects arising from other causes.

Economic Consequences of the Welfare State

323. However, it is possible to identify broadly certain economic consequences which flow from the measures generally recognised as being inherent in the Welfare State. It is with such measures in their relation to the monetary, banking, and credit systems of this country that the Commission must deal.

324. The Associated Banks in New Zealand, in a written reply to a question from a member of the Commission, offered this comment: *"Although social services and social security programmes are desirable in themselves, it must be realised that they involve social cost in other directions."* Mr Whyte, Chairman of the Associated Banks, under examination agreed that, *"One of the factors which today discourages saving is what we would call the Welfare State"*.

325. The Reserve Bank, in a document supplied at the request of the Commission listing the causes of inflation in order of importance, gave as No. 5: *"The Welfare State philosophy which, though good in itself, tends to produce:*

(a) *Heavy Government expenditure;*
(b) *Heavy taxation;*
(c) *Excessive protection to secondary industries;*
(d) *A weakening of incentives;*
(e) *Free spending on consumer goods;*
(f) *A feeling that "nobody must be hurt" by economic forces or political decisions."*

326. Mr P. L. Porter, Chairman of the Capital Issues Committee, in the course of a statement on inflation said: *"The conclusion I came to was that it was really the application of the Welfare State idea of running our affairs that is causing the pressure. The method of dealing with social problems by handing out money was very laudable in purpose but it doesn't seem to work out too well in practice."* He also said: *"The restriction of bank advances, restriction of capital issues – all those sorts of things – are dealing with symptoms"*.

327. Measures for redistributing the national income may do more than merely reduce the purchasing power of one section of the community and correspondingly increase the purchasing power of another section. By increasing the demand for consumer goods and services these measures may create a buoyant market with a consequent stimulation of industry and commerce. Buoyant demand in the market may in turn encourage greater production, but under conditions of over-full employment it is more likely to lead to higher costs, profits, and prices without increased output.

328. But even although measures to redistribute the national income may cause some inflationary pressure, it is through such measures that people are made more secure than they would otherwise be against unemployment, the financial burdens of prolonged illness, and hardship in old age; and are helped through other difficulties that might confront them, such as the adequate education of their children. Reduced hours of work ensure more leisure and should tend to produce better work in the shorter hours. The forty-hour week is part of a long continuing process of improvement in working conditions, and the increased leisure thus acquired is, of course, an element in the standard of living.

329. A higher leaving age for school children, and the continuance of the family benefit from sixteen to eighteen years for children remaining at school, give a better opportunity for education to those who will in time provide the labour force of the country. Those staying longer at school should be better equipped for their work and for their duties as citizens.

330. Assistance for home building or home purchase helps to better the housing of the community and removes a large measure of avoidable hardship.

331. These things are not achieved without cost, direct and indirect, and it has become a responsibility of Government to take account of such cost and to consider both the direct and indirect effects of Welfare State measures upon the community.

The Cost of Social Services as a Proportion of Gross National Income

332. The increasing total payments from the Social Security Fund are imposing a lessening proportionate burden on the expanding national income, as the following table shows:

Year Ended March	Social Security Payments([1])	Gross National Income	Percentage of Gross National Income
	£ million	£ million	
1947	36·8	424	8·68
1948	40·4	480	8·42
1949	43·0	488	8·81
1950	46·4	552	8·41
1951	49·4	696	7·10
1952	54·2	722	7·51
1953	58·8	754	7·80
1954	62·4	834	7·48
1955	67·2	927	7·25

([1]) Source: The Budget, 1952 and 1955.

333. Even when all social services are taken into account, including those paid for from the Social Security Fund, the monetary cost is still not proportionately an increasing burden:

Year Ended March	Gross Expenditure on Social Services([1])	Percentage of Gross National Income
	£ million	
1947	55·0	12·97
1948	61·3	12·77
1949	67·5	13·83
1950	74·8	13·55
1951	81·5	11·71
1952	91·6	12·69
1953	102·0	13·53
1954	109·8	13·17
1955	117·1	12·63

([1]) Source: The Budget, 1952 and 1955.

334. However, the proportionate burden has lessened slightly in the last few years only because the gross national income has risen faster than the expenditure on social services. If there should be any fall in the gross national income, or even if it should become stationary, the picture would be entirely different. In New Zealand, which is so heavily dependent on overseas markets, this is a factor of real significance.

Indirect Effects of Welfare State Measures

335. Everybody contributes through taxation, directly or indirectly, to the cost of the Welfare State. However, broadly speaking, the redistribution of income involves taking money in taxation from those with substantial incomes and transferring it through money payments or free services to those on lower incomes or using it by subsidy to keep down the cost of certain commodities.

336. In other words, money is taken especially from those who have considerable capacity to save (including business concerns) and who would be likely to save and invest money. Much of the money is transferred to those who have less individual capacity to save and are more likely to spend it, or who, if they do save, are more likely to use the savings for subsequent spending on consumer goods and services rather than for long-term investment.

337. While the individual saving capacity of those in the lower income groups is limited, they form so large a part of the population that, as groups, their contribution to the total saving of the community can be very important. Their total spending is of equal moment.

338. The sense of security derived from the State guarantee against unemployment and hardship in old age or through prolonged illness also leads to freer spending. The result of this freer spending is to increase the demand on goods and services (including imported goods) and to add to the upward pressure on prices.

339. In the above circumstances, the Government obtains larger revenues from taxation on increased earnings and there is a tendency to increase State spending. There is consequently keen competition between the State and private individuals or business concerns for labour and materials, particularly in the building industry. This competition again increases inflationary pressures.

340. When housing is undertaken by the State, or given State help through large supplies of credit on easy terms, this adds to the demand on the building industry including the demand for skilled and unskilled labour, and thus tends to increase costs and make it easier to secure higher profits.

341. Shorter hours of work in industry generally, a feature of the Welfare State, must result in lower production and higher prices unless they are offset by greater effort or by improved methods of production, including more efficient equipment. Other social reforms, such as earlier retirement and a higher leaving age for school children, tend to reduce the effective labour force.

342. The cumulative effect of all these aspects of the Welfare State is to contribute to a higher level of demand for consumer goods and services, both locally produced and imported. This higher level of demand results in greater business turnovers and higher profits, also in increased capital expenditure to meet the needs of expanding businesses. In these ways, competition for labour is intensified and, in minimum wage negotiations, resistance to high wage demands is lessened. The Welfare State measures we have discussed therefore contribute to inflationary pressures both directly and indirectly.

The Revision of Welfare State Measures

343. Provisions for the redistribution of the national income need adjustment from time to time to meet changing circumstances, and they have been so adjusted. In 1947, for example, some subsidies were removed and others were reduced. The same thing was done again in 1950. In 1953 the prices of certain commodities were allowed to rise instead of being held by increased subsidies. Similarly, monetary benefits under the Social Security Act have been varied in response to changed circumstances. As an example, a cost-of-living bonus of 5 per cent was granted in June 1950 in consideration of the removal of some subsidies and the reduction of others.

344. The foregoing instances serve to show the close relationship between different measures. This relationship was further exemplified, in the first general wage order made after the reduction of subsidies in 1950, when the Court of Arbitration took cognisance of the effect of the reduction on costs of living.

345. The part played by Government in management of the economy also varies according to circumstances and needs. There have, for instance, been significant changes in the disposal of dairy produce, and in the provisions designed to assure the producer *"of a sufficient net return from his business to enable him to maintain himself and his family in a reasonable state of comfort"* one of the express purposes of the Primary Products Marketing Act 1936.

346. In the marketing of produce of all sorts and in the safeguarding of the primary producer, the Government nowadays plays different parts according to the circumstances of the particular industry. In some cases the Government acts jointly with the appropriate industry in marketing primary products.

347. As Michael P. Fogarty explains in his book *Economic Control*, *"The hall-mark of the Welfare State is, in fact not that the State does everything but that it thinks about everything. Its business . . . is to direct, watch, stimulate, and restrain, and only incidentally to operate".*

The Conflict Between Objectives

348. As we have pointed out in Section Two of this report, there is inevitably, in a managed economy, a conflict between the different objectives of Government, and it is necessary to examine the extent to which a policy will advance one objective of Government against the extent to which it may hinder achievement of another objective.

349. Such conflict makes it harder for the Government to keep the total demand of the community within the capacity of its total physical resources, which is necessary to a sound economy and to the prevention of inflation. The Government, however, has all the requisite powers to accomplish its task. As the Governor of the Reserve Bank indicated under examination, there is nothing in the Welfare State conception which necessarily involves New Zealand in over-full employment or inflation to the present extent.

The Welfare State and Productivity

350. Without making any allowance for sickness or absenteeism, but taking account of holidays and rest intervals during the day, actual productive hours of work at ordinary rates of pay probably do not exceed $35\frac{3}{4}$ per week.

351. There has been a considerable reduction in the proportion of males actively engaged after sixty-five years of age, as shown by these census figures:

1936: 40 per cent.
1945: 30·7 per cent.
1951: 26·5 per cent.

(The proportion of females actively engaged after sixty-five years has always been negligible.)

352. The steady rise in the age benefit, which is dependent on a means test, would seem to be reflected in the steadily reducing proportion of males working after sixty-five years of age. A recent survey shows, on the other hand, that "nearly half of retired Government superannuitants", who are not subject to a means test, are actively engaged. There must be a number of men over sixty-five who would work if there were no means test.

353. Overall productivity has increased considerably since 1936, but part of this increase has been achieved by working considerable overtime at penal rates of pay, which has added to costs. There has been no attempt at the extensive use of shift work. The table contained in paragraph 93 of this report shows that, since 1949, the index of productivity per head of total population has been static, despite extensions to factories, installation of new machinery, and recent notable expansion of agricultural and pastoral activities.

Conclusion

354. There is no doubt that, during the last few years, the considerable inflationary pressures which have been generated in the New Zealand economy have been accentuated and aggravated by measures based on the acceptance by the State of wider responsibility for individual welfare, which is the fundamental principle of the Welfare State.

355. The indirect effect of some of these measures has been to stimulate private expenditure on consumer goods and services and to increase the demand for capital expenditure, both Government and private. At the same time the incentives to private saving have been to some extent weakened by State provision of benefits designed to protect the individual in adversity.

356. On the other hand (as we point out later when examining the relationship between monetary and budgetary policies), measures which the Government must use to control and eliminate inflationary pressures usually involve some diminution of the purchasing power of individuals. On the surface this appears to conflict with the aim of the Welfare State, which is to promote the welfare of individuals. If the Welfare State is to avoid chronic conditions of inflation, which would do much

to harm both the individual and the economy, it must be understood and accepted that the State which pays benefits may also find it necessary to apply remedies involving curtailment of the purchasing power of individuals through taxation and in other ways.

357. Management of the economy within the resources available would still be a problem without the Welfare State. In such circumstances the responsibility of the Government would be less – but so also would be its capacity for effective action, especially under the threat of a recession.

358. In the next section of this report we assess the present monetary, banking, and credit systems of New Zealand before examining the major proposals for reform.

Section Seven

ASSESSMENT OF THE PRESENT MONETARY, BANKING, AND CREDIT SYSTEMS

359. No complex modern economic system could function without the generally acceptable medium of exchange, measure of relative values, and store of purchasing power for the future, which money provides. Nor could a modern economic system based primarily on the institution of private ownership and enterprise survive without a large volume of credit. Money, banks, and credit, in one form or another, are vital to the continued operation of the economy of a modern community.

360. In assessing the present monetary, banking, and credit systems, it is necessary not to overestimate what could be achieved even by a perfect and farsighted monetary and credit policy. The monetary, banking, and credit systems are only some of the many factors which determine the material standard of living which a country can achieve. More important are:

(a) The proportion of the population able and willing to work.
(b) The quality of the labour force, which includes all those engaged in production; their knowledge of advanced techniques; their ability to devise better methods of production and distribution (which implies a high standard of education and the devotion of a proportion of our energies to research); and their willingness to apply their minds and hands to production and distribution (which involves good relations between management and workers, incentives to work and willingness to make and accept innovations).
(c) The quantity and quality of the natural resources available in the country.
(d) The buildings, equipment, roads, schools, pastures, stock, and so on, that is, the social and material capital built up in the past.
(e) The ability and willingness of the people to maintain, improve, and add to that capital.
(f) The terms on which the country exchanges goods and services with other countries.

361. There is at every point of time a limit to the amount which any country can produce or can obtain by overseas trade for distribution among its citizens. This limit cannot be escaped by any manipulation of the monetary, banking, and credit systems, but only by increasing the proportion of workers, improving the quality of the labour force, making better use of natural resources, increasing the quantity and quality of the country's capital, or by an improvement in the terms on which goods and services are exchanged with other countries.

362. Even a perfect monetary system could not prevent some instability or insecurity in a world where new or improved products, services, and techniques are constantly being devised, and where individuals and firms are allowed a large degree of freedom to choose how

they are going to dispose of their money. The implications of this freedom of choice do not seem to be fully appreciated by many people. When these implications are examined, what is surprising is not that the economic system suffers from fluctuations from time to time, but that the fluctuations are not more severe.

363. Those with money have a wide range of choice in deciding what to do with it. The money incomes of private individuals, business, or Government may be used to buy any of a large variety of consumer goods, either imported or locally produced; to buy a section or a home; to pay for services rendered by other persons; to purchase property, equipment, raw materials, and other goods, either imported or locally produced, for use in production or for sale. Some part of the money incomes must be used to pay taxes or rates; some to repay debts; and some may be saved.

364. If there is a decision to save, the money may be hoarded or left on current account with a bank; placed on deposit to earn interest with a savings or trading bank, or other financial institution; used to pay a premium on an insurance policy; lent to an individual, a firm, a local body, or to the Government; or used to buy existing securities. Moreover, in certain circumstances, it is possible to spend in excess of one's income; the individual, the firm, the local body, or the Government may use past savings, or the proceeds of debts repaid to them; may sell some of their material assets or securities; may borrow money either in New Zealand or overseas; or may obtain goods on credit from their suppliers.

365. With this wide range of possibilities it is not surprising that there should be ups and downs of economic activity, not only in particular sections of the economy, but also in the economy as a whole. There is nothing to prevent the members of the community, if they so desire, from spending less than before from their incomes, from borrowing, or from past savings, on domestic goods and services, thus reducing the sums paid out to producers and lowering the total money incomes accruing to them. Again, if they wish, people may spend more on imported goods and less on local goods, in which case local producers again receive less income. On the other hand, it is possible for spending on goods and services in New Zealand to increase through a reduction of savings or through greater borrowing or use of past savings; or because people begin to spend on local goods in preference to imports. In these cases, total money incomes in New Zealand will rise. The real benefit of such a rise in money incomes depends on how far domestic production and imports can be increased to match the increased spending. As we point out elsewhere, restriction of spending and money incomes may be desirable when there is already excessive competition for goods and services.

366. A further complication in New Zealand's case is that the freedom of choice of people overseas may affect our real or money incomes. If they decide to increase their spending on New Zealand's exports, money incomes in New Zealand will rise; if they decide to reduce their spending on New Zealand's exports, incomes in New Zealand will fall. Again, if there is an increase in the prices of overseas goods which New Zealand imports, we cannot avoid paying the higher price; but if there is a decrease, New Zealand benefits.

367. Thus, quite apart from the type of monetary, banking, and credit systems adopted, New Zealand's economy is inevitably subject to disturbance from the effects of new inventions, changes in the patterns of spending and saving of the people, and economic fluctuations overseas.

368. The most that can be expected from the monetary, banking, and credit systems is that they should certainly not aggravate these natural instabilities; and that they should be capable of being used to assist in the economic adjustments which are necessary to enable society to reap the benefits, while countering any drawbacks, of technical and economic changes.

369. The main criticisms of the present monetary, banking, and credit systems made before the Commission were:

(a) That they had held down the standard of living of the country, because they did not provide sufficient purchasing power for people to buy the goods and services which could be produced.

(b) That they had failed to provide the community with money which remained stable in purchasing power.

370. For reasons given elsewhere in this report, we do not agree with the first criticism of the systems. Production in New Zealand has not been retarded in recent years by any shortage of money or spending. Indeed, we believe that productivity might have been increased if spending had been more effectively restrained, in that greater competition would have provided more incentive to improve methods of production and cut costs, and would have reduced the heavy turnover of labour.

371. The second criticism is, of course, valid. For reasons given in Section Five of this report, where the drawbacks of inflation are discussed, no one can view with complacency the fall in the value of money which has occurred in the last fifteen years or so, even though the majority of the people have managed to increase their incomes more than sufficiently to offset the rise in the cost of living, as measured by the consumers' price index. But the fact that we have not enjoyed stability of prices under the present systems does not necessarily mean that they should be drastically revised. For:

(i) In the circumstances, a great degree of instability of prices may have been inevitable under any system.

(ii) The degree of instability may have been due not so much to the systems as to the way in which they have been administered.

(iii) Alternative systems which might have prevented such a degree of instability of prices might have frustrated other objectives to which the Government must have regard.

The problem is to find improvements which could be made in the existing systems or their operation, or to find alternative systems, which would provide greater stability of prices without frustrating healthy economic development, full employment, and other desirable ends.

372. None of the major proposals for reform of the existing systems put to the Commission seem to us to provide an acceptable solution to this problem of instability of prices. Our reasons for this conclusion are set out in detail in the next sections of this report.

373. In our view, no radical reform of the existing systems is necessary, although we consider that their administration could be considerably improved.

374. It must be recognised that the fall in the value of the New Zealand pound during the bulk of the period considered in this report has been in conformity with a world-wide trend. Since 1935, our export prices have risen by about 300 per cent and our import prices by about 186 per cent. We do not believe that there was any practicable means of preventing this increase in overseas prices from generating a considerable increase in prices, incomes, and the volume of money in New Zealand. (See Section Five of this report.)

375. Nevertheless, we believe that the authorities have permitted spending to expand unduly from time to time, with the result that there has been excessive competition for the limited supply of labour and resources available, a greater rise in costs and prices than was justified by external factors alone, and recurrent balance of payments difficulties despite large current earnings of overseas exchange and improved terms of trade.

376. A major factor contributing to the unduly high domestic spending was a large increase in the volume of money. In turn, one of the factors leading to this increase in the volume of money was an expansion of bank advances. This was not a particularly significant factor up till 1949; but advances were expanded excessively during the period from 1949 to 1952 and again in the period 1954–55.

377. The question arises why the undue expansion of advances during these two periods was not prevented by the monetary authorities:

(a) Are there inherent weaknesses in the methods of control available to the monetary authorities?

(b) Have the methods available not been used?

(c) Have they been used with insufficient speed and resolution?

(d) Have the policies of the monetary authorities been frustrated by factors outside their control?

378. Variations of the statutory minimum reserve ratios and the interest rate on advances to the trading banks, the major methods of control available to the monetary authorities, have special limitations arising from New Zealand's banking and economic system. We outline later in the report some of these limitations. **But we are convinced that the failure of monetary policy to prevent an undue expansion of advances in recent years has not been due primarily to weaknesses inherent in the reserve ratio system. The main reasons for failure have been:**

(a) Tardiness in making use of the reserve ratios while direct controls were being relaxed a few years after the war.

(b) Reliance by the authorities:

(i) On voluntary co-operation from competitive trading banks which was not fully forthcoming; and

(ii) On the theory that leaving the banks with only a narrow margin of free cash would induce them to restrict lending.

(c) Insufficient speed and resolution in effectively applying the reserve ratio controls to changing conditions.

(d) Lack of co-ordination between policies designed to control bank advances on the one hand, and fiscal, capital issues, interest rate, and housing-finance policies on the other.

379. In reviewing past events, we have the considerable advantage of hindsight. The authorities are required to make decisions with no certainty as to what will happen in the months ahead, and sometimes with insufficient information on current trends. The difficulties in the way of reaching proper decisions under such circumstances are obvious. The Reserve Bank has been in operation for only twenty-one years. When it raised the reserve ratios in 1952, it was using this weapon for the first time, so that it had no experience of how it would work in New Zealand. It is understandable that, in these circumstances, it should feel obliged to follow a relatively cautious policy. These factors are in our minds as we make the following analysis; but as our task is to formulate constructive suggestions for the future, we cannot avoid drawing attention to measures which appear to us, looking back, to have been inadequate.

1949 to 1952: Reliance on Voluntary Co-operation

380. We recognise that a great deal of the expansion of bank advances between 1949 and 1952 was inherent in the circumstances. There were sharp increases in export and import prices after the outbreak of war in Korea, followed by increases in wages, the complication of the waterfront dispute, and the sudden arrival in 1951-52 of large quantities of imports which traders had expected to receive spread over a period in the future. Nevertheless, the expansion of advances which took place was excessive. We are convinced that greater restraint in the granting of overdraft limits between 1949 and 1951 would have materially restricted the expansion of gross private investment, which rose from £71 million in 1949–50 to £123 million in 1950–51 and to £132 million in 1951–52, and was thus a potent factor in aggravating the existing inflationary situation. It would also have prevented some of the strong demand for imports from becoming effective and thus, perhaps, have avoided the reintroduction in 1952 of control of imports in the form of a system of exchange allocation.

381. The fact that advances expanded unduly in this period would seem to us to have been largely due to the failure of the monetary authorities to make use of the reserve ratio system. The danger of a substantial increase in advances was inherent in the relaxation or removal of direct controls which had previously restrained demand for local and imported goods and services; in the increasing availability of imported goods; and in the high cash reserves held by the trading banks, reserves which were increased considerably between 1948 and 1950 by Government borrowing from the Reserve Bank and between 1949 and 1951 by balance of payment surpluses.

382. The Reserve Bank does not appear to have recognised the need for imposing restraint until towards the end of 1950, for in May 1950 it relaxed its selective advance control policy to some extent. However, in October 1950, and again in May 1951, the Reserve Bank asked the trading banks to adopt a cautious attitude to all requests by customers for increased accommodation. At this stage, in our opinion, the trading banks did not give to the Reserve Bank the co-operation which the circumstances warranted in restraining the expansion of advances. Towards the end of 1951 a directive was issued to the banks under the selective advance control policy, seeking to restrict advances for trading

purposes and for imports, and to have the banks examine overdraft accounts in cases where customers were obviously leaning too heavily on bank finance. It was not until December 1951 that the banks were advised that it was intended to raise the statutory reserve ratios, and the first increase was not made until August 1952. In the meantime, advances had risen from an average of £82 million in the calendar year 1949 to £113 million in January 1951, to £159 million in January 1952, and to £187 million in April 1952. By the last date, the ratio of the banks' liquid assets to their deposits had fallen to a figure which made it desirable, in their own interests, to restrict credit; and a system of exchange allocations had been introduced to protect the country's overseas exchange reserves.

383. Questions were directed to the Governor of the Reserve Bank and to the Secretary of the Treasury during our hearings with the object of ascertaining what factors had stood in the way of an earlier increase in the reserve ratios. The following are extracts from the replies made to these questions:

Question:

Why then was the reserve ratio policy not introduced until August 1952?

Mr Fussell:

I suppose one could trace many types of reasons but I think the underlying one would be that we were operating actually direct controls, and although we started thinking of ratios as direct controls began in post-war years to be diminished, the time to make the transition did not seem to have arrived, but when we felt it was coming along we took it up with the Government to inform them months beforehand – we had to get the Minister's concurrence – and then informed the banks months beforehand, because it was important that a system should not have to adapt itself too suddenly to a new set of conditions and a new type of technique but from the moment we mentioned the new ratio, it had in fact been in force, because they knew from that moment they would have to restrain themselves. At the same time direct control of manpower and materials had receded into the past – all pointed to the transition from direct control to indirect control, but to attempt to do it or even to run it in conjunction with the Import Allocation System would, I think, have been unwise and double-banking, and during the period of the Import Allocation System, or for the latter part, we were introducing it, but the Import Allocation System had to come in regardless of what was being done with indirect control.

Question:

Could you remember when you first suggested to the Government the reserve ratio system should be introduced?

Mr Fussell:

I think it is mentioned in here. If I had to say offhand I would say it is in October or November 1951.

Question:

It had been considered though before that time?

Mr Fussell:

It had been considered but we had not taken it up with the Government.

Question:

Why was the reserve ratio policy not exercised until 1952?

Mr Ashwin:

Well, for the most part prior to that it had not been necessary at all; it had been under direct control; price control, import control, building control; you had the whole thing controlled, under direct control, and there was no need to use the more indirect and certainly more flexible controls through the monetary system.

And again, I think we started about 1949–50 to dismantle them, and the question may be we were a bit slow on going to work on the thing. After all there is no right to assume that because the banks have a bit of leeway in their cash resources that they are going to rush into trouble. They are, after all, responsible people. Again they were a bit slow off the mark. The wool boom came in 1951, and if the wool prices stayed where they were we would have had all that extra sterling and extra buying ability, the advances would have been quite in order.

384. The following quotation from the Government's Economic Survey for 1951 sets out two other factors which appear to have been regarded at that time as obstacles to an increase in the ratios. Such an increase, it said, *"would be difficult to apply at the present time because trading-bank deposits at the Reserve Bank are many times larger than the required minimum, and also because these deposits vary greatly from time to time and between one trading bank and another"*.

385. We do not regard the existence of trading-bank balances at the Reserve Bank many times larger than the required minimum as an obstacle to an alteration of the ratios; indeed, it makes an alteration imperative when the existing situation is already inflationary. The variations of reserve balances from time to time and between one bank and another present difficulties which will always exist in the application of the reserve ratio system. However, as we point out later, these are not insuperable and they are certainly not of sufficient magnitude to justify a failure to impose any increase in the ratio at all. It would appear to the Commission that the monetary authorities were slow to appreciate the need of restraining bank advances, probably because no positive monetary policy had been in operation for many years, while fairly extensive direct controls had been in force. When the need for restraint was recognised, reliance was placed on the policy of selective advance control. This policy had not previously been directed towards reducing total advances, but towards preventing the expansion of credit for speculation and for other purposes inconsistent with the war effort, and after the war to prevent, as far as possible, the use of credit for "non-essential" purposes. The policy was strengthened in 1951 by requests and finally a directive to the banks to tighten up their lending policies.

386. The experience of the period showed that it was unwise to rely on this form of restraint in a situation where competitive trading banks, holding substantial excess cash reserves, were confronted with a very strong demand for advances from credit-worthy borrowers for purposes which were not (at least until the end of 1951) inconsistent with the principles of the selective control policy.

1952 to 1954: Tardiness in Raising Ratios in Light of Changing Conditions

387. The first changes in the minimum reserve ratios were made when the banks were themselves endeavouring to restrict credit and when there was a temporary easing in the demand for advances as stocks were run down from the high level they had reached early in 1952. At the same time, substantial surpluses were achieved in the balance of payments, which led to a large increase in the volume of money and to large additions to the cash reserves of the banks. The minimum reserve ratios were raised by two steps from 10 per cent of demand deposits and 5 per

cent of time deposits in August 1952 to 20 per cent and 10 per cent respectively in May 1953. But the actual balances held by the banks kept well ahead of the amounts which they were required to keep at the Reserve Bank. In 1953 the cash held by the banks averaged 39 per cent of their deposits. Towards the end of 1953 the overdraft limits granted by the banks were again increasing, although up till the end of the year there had been no significant expansion of advances.

388. By the end of 1953, it was evident that restrictive monetary and fiscal policies had become necessary in the best interests of the country, and that a rise in bank advances could only aggravate the existing situation:

(a) Between January 1953 and January 1954 the volume of money increased by over £40 million. This rise in the money supply led to a substantial increase in the purchasing power available to the community.

(b) There was a large number of recorded employment vacancies.

(c) Domestic prices were rising despite a falling trend of import prices, and

(d) The exchange allocation control was being gradually relaxed.

389. Yet, despite the large amounts of free cash in the hands of the banks, the minimum reserve ratios were not raised again until the end of May 1954. By this time total bank credit granted was £16 million greater than in January 1954. **In our opinion, a firmer policy should have been adopted in the latter part of 1953, e.g., by reducing the margin of free cash available to the banks to a very low level and indicating that the reserve ratios and the interest rate for borrowing from the Reserve Bank would be raised speedily and considerably if advances increased to any significant extent.** Mr Whyte agreed, under examination, that if the ratios had been substantially raised at that time *"the effect on trading-bank cash . . . would have been such as to have lowered the level of advances"*.

May 1954 to March 1955: Reliance on Narrowing the Margin of Free Cash

390. Between May 1954 and March 1955 the Reserve Bank appears to have adopted a policy of leaving the banks as a whole with a relatively small margin of bankers' cash above their statutory minimum requirements and of raising the interest rate to make borrowing by the trading banks more costly. On the average, between June and November, the actual balances held by the banks as a whole were about £9½ million above the statutory minimum. Nevertheless, the Bank of New Zealand was borrowing consistently from the Reserve Bank throughout this period. Its need to borrow arose from two factors:

(i) Because it handles the Government's business outside of Wellington, it requires to keep very large holdings of notes in comparison with the other banks. The Reserve Bank has estimated that the Bank of New Zealand requires to hold additional notes to service Government business to an amount of £5·5 million in December and £3 million for the rest of the year. For this reason, it has been agreed to allow the Bank accommodation up to these amounts free of interest, if required to maintain its statutory minimum balances.

(ii) It held fairly substantial assets overseas but did not sell these, as did some other banks, in order to reduce indebtedness to the Reserve Bank. (See Section Two of Appendix C.)

Since £3 million of the amount borrowed by the Bank of New Zealand was interest free, this could really be regarded as an addition to the free cash available to the banking system. Between December 1954 and March 1955, the free cash held by the other banks was substantially reduced – on average to a level of about £3 million among the four of them – and the Bank of New Zealand remained in debt to the Reserve Bank. The interest rate for borrowing from the Reserve Bank was raised from 1½ per cent (at which level it had remained since 1941) to 3½ per cent in April 1954 and to 4 per cent in November 1954.

391. However, despite the tighter policy adopted from May 1954 onwards, advances continued to rise from £148 million in May to £170 million in October 1954, and then, after a period of relative stability until February 1955, there was a sharp rise to £189 million in March 1955. This sharp rise in March was due primarily to advances to customers for payment of taxation and to higher advances than usual in this period to marketing authorities owing to a change in the procedure for marketing primary produce. But the available evidence indicates that the narrowing of the margin of free cash and the raising of the Reserve Bank's lending rate in the second quarter of 1954 did not have any restraining effect on lending by the trading banks. A fair indication of the total credit granted by the banks to private customers may be obtained by adding together their advances and unexercised overdraft authorities. This total rose from £260 million in May 1954 to £280 million in October 1954 and to £288 million in March 1955.

392. There is no doubt that the expansion of bank advances made a considerable contribution to the renewal of inflationary pressures and to the consequent marked upsurge of private imports during this period. Mr Whyte agreed that external factors were not exerting an inflationary influence at the time, that the expansion of trading-bank credit was the major cause of the expansion of the money supply which took place, and that it had been a factor in making effective the desire of the community to increase their spending. (Between the years ended March 1954 and March 1955 gross private investment – including stocks – rose from £84 million to £159 million, personal expenditure on consumer goods and services rose from £530 million to £610 million, and private imports increased from £175 million to £232 million.)

393. The experience of this period indicates that, when the banks are holding cash reserves well above what they would regard as a prudent minimum, it is insufficient merely to reduce the free cash of the trading banks to low levels and raise the interest rate for borrowing from the Reserve Bank as a means of preventing any significant expansion of trading-bank advances. The assumption underlying this policy is that the banks regard the necessity of borrowing from the Reserve Bank as most undesirable and if they see the possibility of such a situation arising they will take rapid steps to restrict their lending. Mr Fussell and Mr Whyte both stated in evidence that trading banks disliked strongly having to borrow from the Reserve Bank. But after May 1954 it should have been evident to the banks that, if the prevailing level of the reserve ratios were maintained, and if advances were increased, they would become quite heavily indebted to the Reserve Bank, especially in March 1955. Yet they granted a substantial amount of additional credit throughout the rest of 1954.(1)

394. In fact, the banks were assisted to avoid any substantial borrowing from the Reserve Bank up till the end of March 1955 by a temporary lowering of the reserve ratios in September 1954, designed to compensate for the drain of cash from the trading banks to the Government as a result of the £10 million National Development Loan and by a further reduction in March 1955 at the income-tax period. On the latter occasion, the Treasury also deposited up to £16 million temporarily with the banks at a low rate of interest in order to prevent their being penalised by a loss of cash ***"for reasons unrelated to their own lending policies"*****. We are not convinced that the difficulties of the banks on these occasions were entirely** ***"unrelated to their own lending policies"*****.**

March to December 1955: Putting the Banks "In the Red"

395. By March 1955, the ratio between the cash held by the banks and their customers' deposits had reached a level which, in view of the continuing deficit in the balance of payments, made it necessary for the banks themselves, for reasons of prudence, to restrict their lending. The following extract from the transcript of evidence makes this clear:

Question:

If there was no Reserve Bank restriction at the present time, would the banks be following substantially the same attitude, or taking substantially the same attitude, in overdraft lending?

Mr Whyte:

They would have to in self-protection if for no other reason, but they would certainly do so in the interests of the country.

396. The authorities have also pursued a firmer policy since March. Between March and October the reserve ratios were raised gradually again by four steps to 24 per cent of demand deposits and 7½ per cent of time deposits and the rate of interest charged to the trading banks for accommodation was raised by three steps to 7 per cent. As a result, the average of the weekly figures of indebtedness of the banks as a whole to

(1) Again, even after the Reserve Bank's interest rate for lending to the trading banks had been raised to 7 per cent in October 1955 – still not necessarily a penal rate to the banking system as a whole – the Bank of New Zealand has preferred, as a matter of policy, to borrow from the Reserve Bank, at times, quite substantial amounts, while maintaining a high level of overseas assets, some of which could have been sold to the Reserve Bank to reduce its indebtedness. In drawing attention to this fact, we are not criticising the Bank of New Zealand's policy in this respect, but merely pointing out that trading banks do not necessarily find indebtedness to the Reserve Bank, even at high rates of interest, so undesirable as to induce them to avoid such indebtedness by changing their policies.

the Reserve Bank or Treasury[1] between 1 April and 31 December was just over £10 million. The figure for December was nearly £14 million. Judging by a statement by the Governor of the Reserve Bank when the ratios were raised in October, the policy of the Reserve Bank in the latter part of the year was to keep the banks as a whole "in the red" to the extent of about £12 million.

397. In addition, there have been abnormally large sales of sterling by some of the trading banks to the Reserve Bank – a total of £20·5 million in 1955. The majority of these sales no doubt arose from a desire by the banks to reduce their debt to the Reserve Bank to a minimum. Though they thus escaped payment of interest to the Reserve Bank, they had to forego the interest which might otherwise have been earned on short-term investments overseas. It is impossible to assess exactly how far the banks have been penalised indirectly in this way by the reserve ratio policy, but they have undoubtedly been affected to some extent. Some banks have also been borrowing overseas during the period, but the amounts borrowed by the banks as a whole do not seem abnormally high in comparison with previous years.

398. In assessing the importance of borrowing by the trading banks from the Reserve Bank, the fact that, for reasons given above, the Bank of New Zealand is able to borrow certain amounts free of interest, should be borne in mind. Yet the figures of total indebtedness of the trading banks (including the Bank of New Zealand) to the Reserve Bank have been used, without qualification, to demonstrate to the public the severity of the reserve ratio policy.

399. In fact, although the average of the weekly figures of borrowing by the trading banks from the Reserve Bank and the Treasury between June 1954 and February 1955 was over £7 million, nearly all of this amount was borrowed by the Bank of New Zealand. Therefore, the average indebtedness on which interest was payable was less than £4 million. Some banks were also granted interest-free accommodation by the Reserve Bank at the time of the National Development Loan in 1954. The Bank of New Zealand was also responsible for over

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(1) Some of the moneys deposited by the Treasury with the trading banks in March 1955 were left with the banks until early in June 1955. Also in December 1955 the Bank of New Zealand borrowed £3 million from the Treasury on fixed deposit at 2½ per cent per annum. In response to inquiries, the Commission was informed that "the arrangement was concurred in by the Treasury on representation from the Bank of New Zealand that its bank-note holdings for the Christmas season requirements in respect of Government business, temporarily and greatly exceeded the normal allowance made by the Reserve Bank by way of interest-free loan. The deposit was made for one month only and was regarded as a temporary adjustment not materially affecting the general control of bank lending". It was considered preferable for the Bank of New Zealand to meet this unusually large seasonal expansion of note requirements on Government account by obtaining a short-term deposit of £3 million from the Treasury, rather than by borrowing temporarily in London, where it had adequate securities available. An understanding had been reached between the bank and the Treasury some time ago that the bank would be assisted by the Treasury in the event of funds being needed to fulfil the statutory reserve ratio requirements. The assistance was to be related to overdraft accommodation (involving considerable direct outlay of overseas funds) granted by the bank to certain Government and semi-Government organisations at the request of the Government. Treasury also deposited with the bank sums varying from £2 million to £3 million between August 1954 and May 1955, in accordance with this understanding.

55 per cent of the borrowing from the Reserve Bank and the Treasury in the last nine months of 1955 and 80 per cent in the last six months of 1955. Therefore, the amounts borrowed must be similarly deflated if a proper indication is to be obtained of the severity of the policy. We can see no valid reason why the existence of the arrangement between the Reserve Bank and the Bank of New Zealand should not have been brought to the notice of the general public and, in view of this, we must express our concern at the use, without qualification, of statistics of indebtedness which could only mislead the public as to the true extent to which the privately owned banks were being penalised by the reserve ratio policy.

How Penal Has Reserve Bank Policy Been?

400. Although the amounts borrowed may seem large, the actual interest paid by the banks has been small in relation to the additional income made by the banks on their higher advances. Total interest paid by all the banks to the Reserve Bank between 1 June 1954 and 31 December 1955 was £180,395. Of this amount, 60 per cent was paid by the Bank of New Zealand. £138,543 of this interest was paid after 1 April 1955, reflecting the firmer policy adopted by the Reserve Bank since that date. In addition, interest amounting to £81,669 had accrued, but was not due for payment, by 31 December 1955. But the average level of advances in 1955 was approximately £25 million higher than in 1954 and £45 million higher than in 1953. Assuming a rate of interest on advances of 4½ per cent the banks' annual gross earnings on advances in 1955 would therefore be about £1·1 million greater than in 1954 and £2 million greater than in 1953. **Even allowing for any consequential increases in administration expenses, and loss of income due to sales of sterling, the banks' additional earnings obviously greatly exceeded the interest payments made to the Reserve Bank.**

401. The policy of keeping the banks as a whole "in the red" to the extent of about £12 million, combined with the Bank of New Zealand's policy of keeping relatively large holdings of overseas exchange in spite of its having to borrow continuously quite large amounts from the Reserve Bank, also had the rather anomalous effect of preventing the intended measure of restraint on lending from operating with full force on the other trading banks. Thus the policy of the State-controlled bank operated, in the circumstances, to shield the private banks.

402. A further drawback of a policy of keeping the banks approximately £12 million "in the red" is that the financial penalty on the banks is increased, not reduced, if they succeed in reducing advances, at least until they have actually reached the figure deemed desirable by the Reserve Bank. In addition, the Commission gained the impression that the Reserve Bank had given the banks no clear objective at which to aim in restricting credit. **It would seem desirable to the Commission that the banks should be given a clear, if necessarily tentative, indication of the Reserve Bank's objectives, and a rather more direct incentive to co-operate with its policy.**

403. Advances fell from £189 million in March 1955 to £176 million in December 1955, a figure £10 million higher than the level of advances in the previous December. The total of advances and unexercised overdraft authorities fell from £288 million in March to £272 million in December, which was £7 million less than the previous December.

There is evidence, therefore, that an attempt was made by the banks in this period to reduce the total of their advances to some extent and it is important not to minimise their achievement in restraining their lending in the face of strong pressure for accommodation. How far the reduction since March 1955 has conformed with the wishes of the monetary authorities is difficult to assess in the absence of any clear statement of the objective of their policy. Since the banks as a whole have in recent months been put more heavily in debt at higher rates of interest, one would assume that the authorities have not regarded the reduction achieved as satisfactory. Again, since it would appear to have been in the interests of the banks themselves to reduce their advances, it is impossible to assess whether the firmer policy of the authorities has been to any real extent responsible for bringing about the degree of reduction that has occurred.

The Need for a Co-ordinated Policy to Combat Inflation

404. Because the spending of the community was not sufficiently reduced by other anti-inflationary policies, a still more rapid reduction in the level of advances would have been advisable in 1955. The continuing high level of private imports and of employment vacancies and many other indications showed that the anti-inflationary policies adopted had not been sufficiently effective up till the time of writing. Inadequate support from other policies has been an important element in the lack of success in controlling advances over the past six years. Inflation cannot be effectively fought on one front alone. The adoption of appropriate policies in such fields as public finance (including housing finance), interest rates, and capital issues would have considerably eased the pressure on the banks for additional credit; pressure which it is difficult for competitive banking institutions to resist, especially when their own liquid reserves are at a high level.

405. Quite apart from making the control of advances more effective, it is most desirable that, when reduction of spending is necessary to control inflationary pressure, it should be effected through a series of co-ordinated measures, covering a wide field of spending, rather than through additional restrictions in one field of activity alone. In the past two years, undue reliance has been placed on control of spending by the restriction of bank advances, with insufficient attention to supporting this control by other means. Should an expansion of spending prove desirable at some future period, it can be achieved most effectively by a variety of measures which ensure that the increase is spread over the community as a whole.

Inadequate Attention to Stimulating Voluntary Savings

406. The best method of effecting a necessary reduction of spending is to induce people to reduce their spending voluntarily. To do this requires an aggressive effort by the Government and by financial institutions to "sell" the advantages of saving, and to make available adequate and attractive facilities for the accumulation of savings. We do not feel that sufficient attention has been given to this problem and we make suggestions later in the report as to measures which might be adopted to increase voluntary savings.

407. However, after a period of rising prices like that through which we have passed, many people will no doubt be sceptical of the advantages of saving, unless it is made clear that the Government is determined to take other action to maintain reasonable stability in the value of money.

408. The Government has not made adequate use in recent years of certain measures which could have helped to restrain spending and thus curb inflation.

Unduly Rigid Interest-rate Policies

409. Interest-rate policy has been too rigid. Although it would be a mistake to expect any marked reduction of spending from a rise in interest rates alone, we are convinced that they have an important part to play in a co-ordinated programme to restrain inflation. A rise would make saving somewhat more attractive and, more important, might encourage those who are forced to borrow to reduce their stocks, to re-examine their building and construction programmes, and to exercise greater caution in buying goods on credit.

Non-banking Credit, Especially for Housing

410. Insufficient attention has been paid to the inflationary effects of some types of non-banking credit. Government policy in the provision of finance for housing, in particular, has not taken sufficient account of the labour and resources available in this field. Although the policy adopted has undoubtedly helped to increase the number of houses constructed annually, it has done so at a heavy price. The effect of a large expansion of credit in a particular field is similar to the effect of a large expansion of spending in the economy as a whole. If labour and resources cannot be expanded in step with the expansion of credit, part of the extra spending made possible by the credit must be dissipated in higher building costs or in higher prices for existing houses. Average costs of dwellings have risen in the past eight or nine years considerably more than most other costs and prices, as shown by Table 55 in Appendix H. And the effect is not limited to housing, for competition by builders for labour and resources raises incomes and costs and leads to pressures for higher incomes in other industries. Moreover, undue expansion of credit in a particular direction may have effects not only on costs and prices in that field, but also on the balance of payments, e.g., an undue expansion of credit for the purchase of motor cars could cause a considerable expansion of imports. For these reasons the Government must pay attention not only to the total volume of money and credit, but also to the extent of credit granted in particular sectors of the economy.

411. The housing programme has also tended to frustrate the Government's anti-inflationary policies, either by reducing the overall budget surplus achieved, or at times by necessitating recourse by the Government or by the State Advances Corporation to the banking system for finance. A recent example is the sale of £12 million of State Advances Corporation stock to the trading banks. Similarly, it is probable that the expansion of private credit, especially of hire purchase and of other forms of consumer credit, has been financed partly by the extension of bank overdrafts, with similar effects. The banks, under the selective advances control policy, are enjoined not to give credit for this purpose,

but is is quite impossible for them in many cases to check on the actual use of funds advanced for other purposes. This is a further reason for paying attention to credit granted by institutions outside the trading-bank system.

Budgetary Policies

412. Although the desirability of using budgetary policy to restrain inflationary pressure has been recognised in successive Economic Surveys, the Government has not in fact made sufficient use of its power to restrain private expenditure in an inflationary period by collecting more from the public, by taxation and borrowing, than it pays out. Governments have, throughout the post-war period, been too ready to grant taxation concessions which economically were in all the circumstances inadvisable. From a short-term point of view, especially to the individuals receiving the concessions, it might appear that the tax reductions were beneficial; but, as pointed out elsewhere in this report, if labour and resources are already fully employed, goods and services available for purchase cannot be rapidly increased.

413. If in these circumstances spending is permitted to expand too rapidly, aided by the tax concessions of the Government, it must lead, in a reasonably free economy, to rising costs and prices and/or to the dissipation of overseas exchange reserves. If costs and prices rise, the temporary benefit of the concessions granted is offset, and perhaps more than offset, by the depreciation of the purchasing power of money, involving a much more haphazard and inequitable form of levy than the taxation normally imposed by the Government. If the excess spending is diverted to imports, the point must eventually be reached where reserves have fallen so far that further reduction cannot be contemplated.

414. Thus, if it failed to curb domestic spending by appropriate budgetary policies, the Government could find itself faced with the unpalatable necessity of introducing vexatious controls over imports and exchange. And even this step would not solve the root problem of inflation, which would then express itself in rising prices or, if suppressed by controls over domestic transactions, in continued shortages of goods and services. The relevance of these remarks to the current situation is examined in a later section of this report.

Conclusion

415. We do not believe that any radical reform of the existing monetary, banking, and credit systems is necessary or desirable. Certainly, none of the major alternatives put to the Commission provides an acceptable basis for reform.

416. In view of New Zealand's continued dependence on overseas trade, some instability of prices and incomes in New Zealand must be expected if instability occurs in our major markets and sources of supply, as has been the case for the bulk of the period under review.

417. In the post-war period, Governments have permitted, and through tax reductions have even encouraged, unduly high domestic spending. This has led to avoidable shortages of goods and services, a diversion of labour and resources from more essential to less essential industries, an unnecessarily steep increase in costs and prices, and recurrent balance of payments difficulties despite continuously high export receipts.

418. The control of bank advances has not been sufficiently effective, primarily because of:

(a) Tardiness in introducing controls through the reserve ratio system:

(b) Reliance on voluntary co-operation by the banks, which was not fully forthcoming:

(c) Tardiness in raising reserve ratio requirements in the light of changing conditions at the end of 1953:

(d) Misjudgment as to the deterrent effect on lending by the banks of narrowing the margin of free cash available to them:

(e) Failure to impose an interest rate for trading-bank borrowing from the Reserve Bank, that made it unprofitable for the banks to expand their advances unduly:

(f) Inconsistency between policies designed to control bank advances and other Government policies.

419. Greater attention should have been paid to stimulating voluntary savings, and greater use should have been made of higher interest rates and a more restrictive budgetary and housing-finance policy as part of a co-ordinated policy to restrain spending.

420. No monetary, banking, and credit systems could create an economic Utopia or fully counter fluctuations which occur for reasons other than the operation of those systems. But we believe that, given wise, timely, and resolute action by the Government and its monetary authorities to counter inflationary and deflationary tendencies, the existing monetary, banking, and credit systems will continue to contribute to the healthy expansion of economic activity in New Zealand, while maintaining the maximum possible degree of freedom for its citizens.

421. Following this assessment of the present monetary, banking, and credit systems, we turn to an examination of major proposals for reform.

Section Eight

REPRESENTATIONS MADE FOR REFORM

I. General Comments

422. In the Preface to this report we point out that, apart from the thirteen witnesses who appeared at the public hearings in response to the direct invitation of the Commission, a further fifty-nine witnesses volunteered personal submissions or presented the views of organisations desiring to make submissions. The Commission also received and considered eighty-nine written submissions on which no appearance was sought. Details of these appearances and submissions are contained in Appendices A and B to this report.

423. Throughout the public hearings, and during the consideration of the written statements, we were greatly impressed by the obvious amount of time and trouble involved in the preparation of submissions. Many of these were very detailed and carefully documented.

424. Substantial portions of some submissions were taken up by historical or analytical surveys of the New Zealand monetary, banking, and credit systems. In the earlier parts of this report, and in Appendices C and H, we set out the facts and figures which appear to us to provide the necessary background against which suggestions for reform must be considered.

425. Suggestions for reform of the present systems were many and varied as might be expected from the wide scope of the terms of reference. The proposals which appear to us to justify special consideration are discussed in the remaining sections of this report. In some instances the persons or organisations mainly responsible for the proposals are mentioned, but in most instances there is no direct reference of this sort. In some cases, many individual submissions were made on the same subject.

426. In this section of the report, before considering special aspects of the monetary, banking, and credit systems, we deal with the following:

(a) State monopoly of the creation of credit.
(b) Social Credit submissions.
(c) The submission of Mr H. J. Kelliher and The Mirror Publishing Co. Ltd.
(d) Proposals for a commodity-backed currency.

II. Should the State Have the Sole Right to Create or Destroy Money?

Introduction

427. A number of witnesses contended that the State should have the sole right to "create" or "destroy" money and that the trading banks should not be permitted to do so. This contention was fundamental

to the proposals of Mr H. J. Kelliher and The Mirror Publishing Co. Ltd., and it received some support from the New Zealand Social Credit Association and from a number of other witnesses.

The Origin of Creation of Money by Banks

428. The process called "creation of credit" or "creation of money" is no new development. Its origin in England in the seventeenth century as a development of the activities of the goldsmiths is described in the following passage from *The Theory of Credit* by Macleod (first published in 1891), Vol. II, Part II, at page 520.

When a customer paid in money to his account: and when they discounted a merchant's bill: they simply gave them a Credit in their books: which in the technical language of banking is termed a Deposit. Moreover, in order to diminish the demand for actual payment as much as possible, they agreed with their customers to make these Credits or Deposits as transferable as money itself: and to pay any person to whom their customers had transferred their Credits, in the same way as to themselves.

These Credits, or Deposits, were transferred by means of paper documents, which were of two forms—

1. Either the Goldsmith gave his customer a written promise to pay to himself, or to his order, or to bearer on demand, such a sum as he asked for: these notes were in simple writing: and were called Goldsmiths' Notes.
2. The customer might write a Note to the Goldsmith, directing him to pay a certain sum to any person, or to his order, or to bearer, on demand: these Notes were at first termed Cash Notes; but in modern language they are termed Cheques.

These two forms of documents were thus as transferable as Money itself, and produced all the effects of Money. And by experience, the goldsmiths soon found that they could keep afloat an amount of Credit considerably exceeding the amount of cash they kept to meet the demands upon them; and this increased quantity of Credit was in all its practical effects exactly equivalent to an increase of Money of equal amount.

People found it much more convenient to lend their money to the goldsmiths, where they could have it whenever they pleased along with high interest, than to lend it out on real or personal security. The goldsmiths soon received the rents of all the gentlemen's estates, which were transmitted to town. Five or six stood pre-eminent among their brethren, and Clarendon says that they were men known to be so rich and of such good reputation, that all the money in the kingdom would be entrusted in their hands. These goldsmiths, then, first came to be called Bankers.

429. At page 870 of the same work, Macleod defines "banking" in the following terms:

The business of banking does not consist, as is so commonly supposed, and as stated in books and documents which might be supposed to be of authority, in borrowing money from one set of persons and lending it to another set: but in creating and issuing Circulating Rights of Action, Credits or Debts, on a given basis of bullion, several times exceeding the basis; according to the different degrees of perfection on which the system is organised. These Circulating Credits have exactly the same effects, in every respect, as an equal quantity of money.

430. The views of Macleod are supported by the following extract from *An Outline of Money* by Geoffrey Crowther, (1948), page 26:

And finally, the goldsmith, now fully developed into banker, makes the discovery that he can safely issue deposit-receipts in excess of his gold stock. It is immaterial whether he does this by printing off more receipts and lending them to people in need of accommodation (or indeed using them to pay his own household bills), or whether he does it by allowing his customers larger "deposits" (on which they can draw by cheque) than the value of the gold they have deposited. In either case the crucial step has been taken. The principle of "creation" of money has been discovered. At first, the goldsmith was doubtless cautious in his "creation". Then later, with growing confidence, he went too far. But gradually he accumulated experience about the proper proportion of actual gold to keep in reserve . . .

But the unique function of the banker, and the one that makes him important for this book, is . . . the provision of a convenient mechanism by which people can make payments to each other without having to walk around to each other's houses with bags of coin. And in providing this mechanism he also provides, or "creates", the money itself. He has discovered the secret, for which the medieval alchemists strove, of manufacturing money. So at least it seems, though we must now examine more closely this apparently miraculous business of "creation".

431. The above extracts indicate that historically the creation of credit has been inseparable from the business of banking. They disprove a statement by Mr Kelliher that, *"Nowhere in the literature is it authoritatively stated that the function of banking is to create money"*. Appendix D, Part II, to this report contains a number of further extracts which indicate that the explanation of the creation of credit by banks has been a common feature of textbooks on economics for many years.

The Legality of Creation of Money or Credit by Trading Banks

432. Mr Kelliher went so far as to contend that, in conducting their operations as they do, the trading banks in New Zealand were breaking the law because creation of money by the trading banks was a breach of the Crown's prerogative, and because the creation of money or credit was not properly part of the functions of a trading bank. Because of the inadequacy of the legal argument both for and against these contentions, the Commission requested the Minister of Finance to seek the independent advice of the Solicitor-General, whose opinion on the issue is attached to the report as Appendix D, Part I. In essence, this opinion affirms that:

(a) The Royal Prerogative in respect to money matters *"relates primarily, if not exclusively, to the regulation of the coinage"* and has *"no application whatever to the creation and issue of 'credit'"*.

(b) On the authority of the Privy Council in the case of the *Attorney-General for Alberta* v. *the Attorney-General for Canada* (1947), *"it is not beyond the business covered by the word 'banking' to make loans which involve an expansion of credit . . ."*

(c) There is no doubt *"that the 'creation of credit' is a legitimate function of a trading bank which has been duly authorised to carry on the business of banking in New Zealand, and that in performing this function such a bank is in no way invading or usurping the prerogative of the Crown or infringing any other principle or rule of law"*.

433. After considering all the material before it, the Commission rejects the contention that the operations of the New Zealand trading banks under the existing banking system are illegal.

Creation of Money and the Public Interest

434. Apart from the historical and legal aspects outlined above, the next question to be considered is whether it is in the public interest that the power to create or destroy money or credit should be withdrawn from the trading banks and reserved to the State or to institutions owned by the State.

435. The burden of the contentions of those who sought to deprive the trading banks of the power to create and destroy money was that the trading banks for their own profit sometimes expand the money supply

to an undesirable extent and so cause inflation, and in other circumstances, such as in times of economic depression, cause an undesirable reduction in the money supply by reducing advances.

436. In the view of the Commission the Government possesses adequate powers to prevent any undesirable expansion of trading-bank credit. It can do this through the Reserve Bank under the reserve ratio system and, if it is so desired, it could take special steps through the Bank of New Zealand which it owns. The Governor of the Reserve Bank said in evidence that the Reserve Bank could prevent the trading banks from making any further expansion of advances if at any time it was considered desirable to do so.

437. The Commission does not regard the existing reserve ratio system as a perfect instrument for controlling trading-bank advances, and later in this report we make suggestions for improvements in the system. We have no doubt, however, that it can be used to restrain lending by the trading banks provided the Government and the Reserve Bank are sufficiently resolute in their determination to restrict such lending.

438. There is, of course, the possibility of bringing about necessary expansion of the money supply entirely by financing Government expenditure from Reserve Bank credit, and by at the same time preventing trading banks from expanding their lending through a rigid application of the reserve ratio. We consider that the needs of industry and commerce for additional credit can be more conveniently and efficiently met by expansions of trading bank credit than by expansions of Reserve Bank credit. The trading banks are in close touch with the multitude of industrial, commercial, farming, and other businesses and they are in a position to give attention to the needs of individual businesses.

439. The Commission is convinced that there is no real danger of the trading banks attempting to bring about an undue restriction of trading-bank credit for their own purposes during a recession. It is in the financial interests of the trading banks to see that their advances do not fall unnecessarily since interest on advances is the main source of the banks' income. In any event, the Government, having complete ownership and control of the Bank of New Zealand, is in a position to ensure that sufficient trading-bank credit is made available, providing credit-worthy customers exist and are willing to borrow.

440. The trading banks in New Zealand are able to create and destroy money through their lending transactions (subject to certain definite limitations discussed elsewhere) basically because a very substantial proportion of commercial and industrial business in New Zealand is transacted by trading-bank customers through current accounts at the trading banks, known as demand deposits, and because these deposits, transferred by cheque, constitute a customary and generally acceptable form of payment. Because so large a part of business is done through the trading banks by this means, any expansion of advances by a New Zealand trading bank is likely to result in some increase in the total of demand deposits held by bank customers and therefore in the creation of money. Similarly, a reduction of trading bank advances tends to reduce the total of demand deposits and therefore to destroy money. The trading banks can create additional money only if they have balances at the Reserve Bank (including any amounts borrowed from the bank)

more than sufficient to meet their reserve ratio requirements. Otherwise they can expand lending to some customers only as other customers repay their loans.

441. The essential ingredients in creation of money by the trading banks are:

(a) Their ability to make additional advances on overdraft.

(b) The fact that they handle the bulk of commercial and industrial business of the country through the cheque system.

(c) The fact that a large proportion of their advances is not withdrawn in cash but is deposited within the trading-bank system.

442. To ensure that the trading banks do not create or destroy money it would be necessary to prevent them from increasing or decreasing the existing level of advances, because either an increase or a decrease in total trading-bank advances will in part at least be reflected in an increase or decrease in the total of customers' demand deposits. As mentioned previously, it is practicable to place an upper limit on trading-bank lending through the reserve ratio system, but below whatever limit the Reserve Bank imposes it appears to the Commission impossible to prevent increases and decreases in trading-bank lending from affecting the level of customers' demand deposits and thus creating and destroying money.

Nationalisation of Trading Banks Not Advocated

443. One means of preventing privately-owned trading banks from creating and destroying money would be to nationalise them. However, neither Mr Kelliher nor the New Zealand Social Credit Association favoured this course, although Mr Kelliher presented it as a likely consequence if his own scheme were not adopted.

444. After reviewing all the evidence submitted, the Commission is satisfied that the private trading banks operating in New Zealand are providing an efficient service to the community at reasonable cost. And the Government, through its ownership and control of the Bank of New Zealand, is in a position to control the cost of banking services to the public should it be found necessary to do so. In these circumstances, there appears to the Commission to be nothing inherently wrong in part of the process known as the "creation or destruction of money" being undertaken by private institutions.

Conclusion

445. The essence of the matter is that insufficient or excessive credit creation can have important repercussions on the whole economy and, for that reason, control should be exercised by the Government through the Reserve Bank and, if necessary, through the Bank of New Zealand. Such control can be exercised under existing legislation. Furthermore, the Government has itself adequate powers to create money through the Reserve Bank or through its ownership of the Bank of New Zealand.

446. To concentrate the whole of the trading-bank activities or the whole business of credit creation in a Government monopoly of banking would, in the opinion of the Commission, lead to an undue and unnecessary aggregation of power in the hands of the Government. It would remove a highly desirable element of competition and it could not be expected to provide as good a banking service as the commercial community now enjoys.

III. Social Credit Submissions

Introduction

447. The Commission received oral or written submissions from forty-eight persons or organisations who claimed to be supporters of Social Credit or who made suggestions which were closely akin to the principles of Social Credit.

448. Much time was given to the submissions of the New Zealand Social Credit Association, which were approved by the New Zealand Social Credit Political League. They were presented by Miss M. H. M. King and Mr R. G. Young, Vice-Presidents of the Social Credit Political League, of which Mr Young was in addition acting-leader at the time in Mr W. B. Owen's absence overseas. Both Miss King and Mr Young were also members of the New Zealand Social Credit Association, although without executive office. Almost eleven days of our hearings were devoted to the reading of brief statements by these witnesses, lengthy cross-examination on the statements, and the opening and final addresses of the Association's counsel, Mr F. C. Jordan. Mr Jordan claimed that together the Association and the League represented most of New Zealand's social crediters (to adopt his own term). However, a number of other witnesses who claimed to be social crediters made their own submissions which differed in matters of substance from those of the Association. The evidence of the Association's witnesses under examination was also in many respects inconsistent with the Association's prepared submissions, in some instances to the point of withdrawal.

Differences Between the Social Credit Association's Submissions and the Election Policy of the Social Credit Political League

449. The Association's submissions differed in important aspects from the policy which the Political League submitted to the electors in 1954, and Mr Jordan objected strongly to any questioning of the Association's witnesses on this policy, or on Social Credit political literature. He explained that the political policy had aroused the *"strongest resentment"* among some Association members, and that as a result it had been reconsidered and *"rectified"* in certain matters. From Mr Jordan's explanation it became clear that the case prepared for submission to the Commission did not conform with what many people have come to accept as Social Credit theory and policy.

Consideration of Social Credit Literature

450. Mr Jordan also at first objected to the examination of witnesses on any Social Credit publications other than the Association's submissions, but finally withdrew this objection. During the hearings the Association's witnesses under examination and Mr Jordan in his remarks rejected or substantially modified a number of important propositions contained in Social Credit publications. For example, Mr Jordan described the A + B theorem as of only "academic interest", and Mr Young admitted important flaws in the A + B theorem and in the examples of its application given in *How Social Credit Works,* compiled by Mr W. B. Owen, leader of the Social Credit Political League. Yet the core of the Social Credit theory that there is a chronic gap between purchasing power and prices, as conceived by its founder Major Douglas, and as expounded in the past by the Social Credit movement, has been the A + B theorem.

451. The Commission has not felt it desirable to trace and discuss in the main body of its report all the inconsistencies with which it was confronted. It has decided to consider here the principles and proposals which seemed to be commonly accepted by most of the social crediters who appeared before it. For a fuller account of the Social Credit Association's proposals, for an indication of the significant withdrawals and departures during the hearing from the original submissions of the Association, and for a better understanding of the differences between the various versions of Social Credit, a study of Appendix E to this report is necessary.

Social Credit Analysis of Existing System

452. The social crediters regarded the present system as inherently defective. They drew attention to the fact that public and private debt, taxation, and the cost of living have all been increasing. They claimed that there was no real security for the individual or the nation.

453. The basic reason for these defects they gave as a *"chronic gap"* between the amount of purchasing power in the hands of the people who want to buy goods and services and the prices which sellers must charge to earn a fair return on the goods and services which they can produce; that is, a chronic shortage of purchasing power.

454. A chief cause of the gap, they claimed, is that the banking system has a monopoly of the creation and destruction of money, so that all money comes into existence as a result of interest-bearing loans to producers from the banks. They argued that, since no money is created to pay the interest charges on these loans, the members of the community can meet them only by impoverishing one another or by going more deeply into debt to the banks.

[NOTE—For convenience the term "gap" is used in the rest of this report, although, as pointed out elsewhere, we are convinced that no gap in the sense postulated by the social crediters has existed in recent years.]

455. This position, they said, is aggravated by the fact that persons and business firms save part of their incomes.

456. For these reasons, in their opinion, at certain times there are depressions while at others, as in New Zealand since 1936, the community bridges the gap by such means as the extension of the time-payment system and the growth of public and local body debt, or by struggling to find export markets overseas. Miss King claimed that the growth of public and local body debt between 1933 and 1953 *"measures the extent to which depression is kept at bay by the State or local bodies undertaking capital projects financed on debt money"*.

Social Credit Proposals for Reform

457. To remedy this situation, the Association proposed that a National Credit Authority should be set up first to ascertain, through a national survey, the extent of the gap, and, secondly, to direct the amount of extra purchasing power which should be issued *"debt free"* to balance production and consumption. The extra purchasing power could be issued in many ways, but the Association proposed that it should be used by the Government to: (1) reduce taxation; (2) increase social security benefits; (3) subsidise retailers who would reduce their

selling prices to agreed figures; and (4) pay for public works of a non-commercial nature. Other Social Credit witnesses did not appear to think that a survey was necessary, and indicated that the Government could henceforth finance all its expenditure with debt-free money, thus avoiding the need to tax or borrow from the people.

Examination of Social Credit Analysis

458. The Social Credit view of the defects of the existing system lacks perspective. For example, it is true that the absolute amount of the public debt has increased considerably since the 1930's, but a balanced assessment must take account of such factors as the changes which have taken place in the national income and in the relative proportions of the debt held overseas and in New Zealand since that time. When that is done, it is evident that New Zealand's debt today is a very much lighter burden than it was twenty years ago. In 1932–33, to take the years chosen by the Association, the total public debt was more than double that year's gross national income; in 1954–55, it was only four-fifths of the gross national income. In March 1933, the Government's overseas debt was £174 million; in March 1955, it was £100 million. In 1932–33, overseas interest payments used up £18 in every £100 of overseas earnings; in 1954–55, interest payments used only £1 2s. in every £100.

459. The growth of private indebtedness, which the social crediters regard as another defect of the existing system, is largely a transfer of purchasing power from one group of people to another. And, of course, both public and private debt largely represent savings which have been lent to the Government, to local bodies, to business concerns, and to individuals, and have been put back into circulation by the borrowers. What somebody owes somebody else owns. New Zealand's recent prosperity and expansion have increased the opportunity to save and the need and the willingness to borrow. Increased public and private debt is very largely a reflection of rapid social and industrial development financed from savings.

460. Similarly, taxation should be related to the national income and to the purposes for which the taxes have been used. Taxation has increased since 1938–39, even as a proportion of the national income. But the ratio of taxation to the national income has increased mainly because a larger part of the money collected through taxation is now used to redistribute income through social security and other monetary payments, and to finance capital works for which money was previously borrowed. The vital fact is that the Government itself is using a slightly smaller share of the nation's real resources than it did before the war. And, as Social Credit witnesses so often pointed out, it is real resources, not monetary values, that matter.

461. Again, there has been a rise in the cost of living in recent years, and those people on relatively fixed incomes have suffered as a result. But the average citizen has a substantially larger real income and consequently a higher standard of living than before the war. In addition, the security of the individual has been improved by the extension of social security benefits, by the accumulation of substantial reserve funds for the primary industries, and by the virtual disappearance of unemployment in New Zealand.

462. In short, the Social Credit witnesses gave a completely distorted description of the state of the New Zealand economy, emphasising those facts which gave colour to their arguments, but ignoring many other facts essential for a balanced appreciation.

463. The Social Credit claim that all new money comes into existence as an interest-bearing debt to the trading banks is contrary to fact. Only about half (£139 million) of the increase in the volume of money (£271 million) between June 1935 and June 1955 was due to trading-bank advances. About £20 million came from Government borrowing from the banking system (mainly from the Reserve Bank) and another £77 million came from overseas transactions. The balance of the increase is accounted for by a number of other factors which individually are relatively unimportant.

464. Reserve Bank lending, as we show later, does not involve borrowing in the ordinary sense, and the increase in the volume of money from overseas transactions does not usually involve borrowing in any sense. When New Zealanders obtain overseas funds, mainly from the sale of exports, they sell this foreign exchange to the banks in return for the equivalent in New Zealand money. On the other hand, New Zealanders who have to make payments overseas, chiefly importers, buy the necessary foreign exchange from the banks with New Zealand money. When overseas receipts exceed overseas payments, as they did in the main between 1939 and 1954, the banks buy more foreign exchange than they sell, and the volume of money in New Zealand is correspondingly increased – without debt or interest.

465. In any event, payment of interest to the banks does not cause a shortage of purchasing power, as the Social Credit argument runs. Nor does a shortage of purchasing power necessarily arise from business and private saving, another Social Credit contention. If bank interest, reserves set aside by business concerns to provide for depreciation and contingencies, and savings of private individuals all represented purchasing power withdrawn from circulation, as the social crediters contend, the national income would fall and the purchasing power of the community with it. But this money is not hoarded; it is normally spent into circulation; and the assumption that it is hoarded is a grave, basic fallacy in the Social Credit proposition.

466. The banks do not destroy or hoard their interest receipts. They use them to pay wages and salaries to their staff and dividends to their shareholders, and to make purchases from other firms which in turn use their income in a similar way. Business concerns normally use within the business the funds which they set aside as reserves, or sometimes use these funds to buy shares and securities. Private individuals commonly place their savings with some financial institution such as the savings banks, which by this means are enabled to increase lending. or they also acquire shares or securities.

467. In all instances the money is either spent directly or is made available for borrowing by others to spend. The Association's witnesses finally conceded this point, and, incidentally, recognised that the lending and borrowing of private savings is a basic necessity if a system of private ownership and private enterprise is to be preserved, an objective which they considered desirable.

468. However, the Social Credit witnesses carried the argument one step further. They claimed that the investment of savings meant the reappearance of the same money in a fresh set of transactions which included new costs but that no new money was made available to meet these costs as reflected in prices. This is an instance of another basic Social Credit fallacy – the fallacy that new money must be created to finance every new transaction.

469. Most of the Social Credit witnesses did not seem to appreciate that money circulates, that one bank note or bank deposit may be transferred several times during a year, thus financing several transactions and becoming part of the incomes and expenditures of several people. Some of these witnesses implied that each unit of money was cancelled as soon as if it had been spent and that fresh supplies of money were needed to finance each new transaction.

470. A relatively small amount of money is enough to finance a very large volume of business. There is no need – and indeed it would be disastrous – to create new money for every transaction which takes place in the economy. Yet that is what the Association's argument on this aspect of the monetary system amounts to. This argument is totally destroyed by a comparison of all transactions settled by cheque with the volume of bank money available. For the year 1954, the value of cheque transactions (excluding Government transactions) was £4,430 million, but the average value of deposits and unexercised overdraft authorities in that year was only £344 million.

471. We agree that if people hoard their savings instead of investing them, or if financial institutions fail to find borrowers for the savings placed with them, the community's spending is likely to fall, and the national income also. But no deficiency of purchasing power need arise if the saving of some individuals or business concerns out of their incomes is matched by the spending of other individuals or business concerns in excess of their incomes, either by the use of past savings or of borrowed money. And, of course, there may also be times when purchasing power is increased through the spending of some members of the community, from borrowed money or from money saved in the past, exceeding the current savings of other members of the community.

472. This is one of the fundamental and generally accepted explanations of the ebb and flow of economic life in the past. But it provides no foundation whatever for a theory that there is a permanent shortage of purchasing power.

473. Growth of public and private debt provides no evidence of a general shortage of purchasing power. For instance, examination of the holdings of the Government's internal debt shows that most of the increase which has taken place since the 1930's can be attributed to the investment of savings by the public, either directly or through savings banks, insurance companies, and so on. In other words, some people have found it unnecessary or undesirable to spend part of their incomes and have transferred the money temporarily to the Government in return for an agreed annual interest payment. In addition, substantial reserve funds have been accumulated by the primary industries – another form of saving – and invested in Government securities. Similarly, private indebtedness largely represents a transfer of income from one set of persons to another.

474. The Social Credit suggestion that our need to export primary produce is due to a deficiency of purchasing power in New Zealand is absurd. The local market could not absorb all our wool, meat, and dairy produce, and without imports, which can be bought only with foreign exchange earned by exports, we could provide very little of the material and equipment essential to our farming, manufacturing, and service industries. Indeed, without imports, the New Zealand economy, as we know it, would cease to function. To give only one example, without petrol and oil all forms of transport dependent on these fuels – motor cars, motor lorries, passenger buses, farm tractors, and aeroplanes – would be brought to a standstill, the transport system would collapse, and mechanical farming would come to an end.

Examination of Social Credit Proposals for Reform

475. Under examination after they had heard a good deal of the evidence put before the Commission, the Association's witnesses themselves seemed at least to have revised their estimates of the extent of the gap and even to have begun to doubt its existence in recent years. It does not require a national survey to prove to the Commission that, since the war, spending has been generally excessive in New Zealand in relation to the goods and services available. Certainly some people have had insufficient income to buy the goods and services which many people regard as providing the basis for a reasonable standard of living, and some have suffered from the continually depreciating value of their savings or their relatively fixed incomes. But evidence that some people have not enough purchasing power is not evidence that the community as a whole has not enough purchasing power. All the evidence, in fact, points to the existence of too much purchasing power. There has been no undue accumulation of stocks; there has been a very large number of employment vacancies; and prices have risen constantly. These conditions would not have prevailed if there had been insufficient purchasing power in the hands of the people as a whole.

476. The Association's counsel made it quite clear that *"there is no necessity for the creation of any money to balance available goods and services with purchasing power . . . if the gap does not exist"*. Since there is obviously no gap we cannot recommend any issue of debt-free money at the present time.

477. It is recognised that more money will be required as our production and population grow. If it seems expedient, the Government can use its control of the trading banks through the Reserve Bank to prevent the provision of this extra money by way of bank overdraft, which the Association claimed increases the debt burden of the community. And, if circumstances seem to demand that more money should be put into circulation debt free, as the Social Credit Association urged, this also can be done by financing Government expenditure through the Reserve Bank. Today, when the Government borrows money from the Reserve Bank it can set its own terms as to interest and repayment; it need not repay the loans if it is felt desirable that the money should remain in circulation; and the Government even now pays the interest to itself (as the owner of the Reserve Bank, the profits from which are paid into the Consolidated Fund). That is not borrowing in the ordinary (and to the Social Credit Association, objectionable) sense.

478. Since the Government, therefore, already possesses all the powers the Social Credit Association wishes it to have, the only question is whether the issue of debt-free money is desirable or advisable.

479. The Commission is most strongly opposed to meeting the need for extra money in the future through the Government issue of debt-free money.

480. In normal times, when additional credit is necessary to finance increased production, it is more appropriately provided through the trading banks. They are in direct and frequent touch with farmers, traders, and business houses of all sorts, and are in the best position to judge the needs and estimate the resources of their customers. The conditions of trading-bank advances – repayment when called upon and the payment of interest – are in themselves some brake on excessive demand for credit.

481. Even in these circumstances, too much may be advanced and too much purchasing power may be made available. Through its ownership of the Reserve Bank and its power to direct Reserve Bank action, the Government can, however, limit trading-bank advances. In addition, as the owner of the Bank of New Zealand, which handles two-fifths of the trading-bank business of the country, the Government is in a position to form its own opinion of, and to influence, trading-bank policy. These important aspects of the monetary, banking, and credit systems are fully discussed elsewhere in this report. Here it is enough to point out the measure of Government control of credit within the existing system.

482. It might appear that costs and prices would be lower if all the extra money required were issued debt free to the Government rather than through trading-bank loans to industry. This idea is largely illusory. As population and production grow, firms will need more working capital; if they cannot get it from the banks, they will have to increase their capital, borrow at interest elsewhere, or increase their prices. Likewise, the expenses of the trading banks will increase as the number of depositors and the volume of deposits rise; if they cannot increase their advances and investments, which are the main sources of their income, they would probably have to raise their charges for keeping accounts.

483. The community's need for more purchasing power in ordinary circumstances is vitally different from the need in a depression. A direct increase in the incomes of consumers is urgently necessary in depression conditions to enable what is produced to be sold and to maintain full employment. At such a time a Government might properly issue money through the Reserve Bank, and no doubt would. But even then it would be unwise to use debt-free money.

484. If the Government adopts a policy of issuing debt-free money to pay for its capital works, it enters into very one-sided competition with the private sector of the economy for the labour and resources available, and the community gets a completely false picture of the real cost of such works. In our view, there is a grave danger that this false picture would lead to pressure upon the State to take over from private firms services which, in terms of real resources used, it could run no more efficiently, but which, by reason of its favoured financial position, it could supply more cheaply in money terms, at least in the short run.

485. Similar considerations apply in the case of the use of debt-free money for the payment of benefits or subsidies. If these must be financed by taxation, there is a potent check on extravagance, in the form of critical scrutiny by the taxpayers who are relieved of part of their income to enable the payments to be made. If it is conceded that benefits and subsidies may be financed by an issue of debt-free money, this check is removed, and the pressure on the Government for extra benefits must increase.

486. Thus, serious objections to reliance upon debt-free money to expand the money supply as population and production grow are:

(a) It would give a false picture of the real cost of Government operations;
(b) There would be pressure for the State to take over functions which it could perform no better than private firms;
(c) It would be very difficult to keep the issue of debt-free money within the bounds of prudence; and
(d) If an excessive issue were made, costs and prices would be driven up very steeply and rapidly.

487. Among the uses suggested for debt-free money by the New Zealand Social Credit Association were:

Tax reductions:
Increased social security payments:
Price subsidies.

488. This proposal reveals an immediate problem. If in one year taxation were reduced and the reduction off-set by the issue of debt-free money, in the following year taxation would either have to be restored to the old level or more debt-free money issued to meet the deficiency. Similarly, an increase in social security payments would either have to be financed by more debt-free money in the second year or the payments would have to be cut back to their old level. The same would apply to prices; either more debt-free money would have to be issued to keep them down by subsidy or they would have to be allowed to rise again. The same process would have to be repeated year after year.

489. If £80 million to £90 million of debt-free money were issued in the first year of a Social Credit Government, as Miss King and Mr Young at one time appeared to believe practicable, by the end of the year the volume of money would have risen by about one-third.

490. Unless the debt-free money could be cancelled out of existence the result of repeated issues of debt-free money of this magnitude would be most serious chronic inflation. Although they recognised *"the utmost importance of cancellation"* – Mr Young said that it was fundamental to the Social Credit case – the Social Credit witnesses were unable to show how the money could be cancelled. The Commission can only conclude that it would never be cancelled.

491. Inherent in the Social Credit proposals is the belief that an increase in the volume of money will bring increased production of goods and services. Money is, of course, only power of demand over goods and services; the issue of money will of itself produce nothing. At a time like the present, when the resources of the community are already fully employed, production can be increased only by acquiring

more land, labour, or capital, or by making more effective use of the existing supplies. The social crediters were unable to show us that the issue of more money would in these circumstances produce anything but higher prices.

492. Perhaps the belief that the issue of large quantities of new money would be beneficial rests mainly on a confusion between what is good for the individual and what is good for the community as a whole at a time when resources are fully employed. We know that if, as individuals, we won a lottery or received a substantial increase in pay we could buy more of what we want. But, if an issue of debt-free money for tax reductions or increased benefits gave us all the equivalent of a lottery prize or a pay increase, no one would be better off at a time when resources were fully employed. The extra money would of itself produce no more goods and services.

493. It is not surprising that a doctrine like Social Credit should have flourished during a depression, a time when the resources of the community were very far from fully employed. When large numbers of people are unemployed, when wages and prices are falling, and when stocks of goods stay unsold on shop shelves, to put more purchasing power into the hands of the people certainly improves matters. But, when business and industry are consistently many thousands of workers short of their needs, when there are recurrent shortages of goods and services, and when prices are continually rising, there is no advantage but on the other hand real and grave danger in the issue of large quantities of new money.

494. The extra money would not remain unspent; nor would it be cancelled out of existence as soon as it was spent as some witnesses appeared to believe. We would merely have more money chasing a relatively constant supply of goods and services. Inevitably prices would be driven up by extra competition for the goods and services available. If the tax concessions and increased benefits financed by the new money were continued in subsequent years – involving more and more issues of debt-free money – New Zealand would be engulfed in rapid inflation which would bring in its train economic, political, and social problems of a magnitude which it is to be hoped New Zealand will never be required to face.

495. It was made quite clear to us that, in the words of Mr Young, *"there is nowhere in the world where the financial technique of Social Credit is in operation"*. Social Credit theory has, therefore, not been put to the test of practical application.

496. In our view, the Social Credit analysis of the existing position in New Zealand was falsely based, in that it:

(a) Grossly exaggerated the importance of increases in public and private debt and in taxation.

(b) Assumed, contrary to fact, that all money comes into existence as an interest-bearing debt to the banks.

(c) Wrongly assumed that bank interest and business and private savings are hoarded and withdrawn from circulation.

(d) Ignored the fact that money circulates, a relatively small amount of money being enough to finance a very large amount of business.

(e) **Accepted the false premise that, because some people have not enough money to meet all their needs, the whole community must be short of money.**

497. The Social Credit witnesses failed to produce any evidence of a chronic gap between purchasing power and prices although, as they admitted, the existence of such a gap is the whole basis of Social Credit. Under examination, Mr Young agreed to this proposition: *"No gap, no Social Credit"*. A similar admission came from Miss King.

498. During the hearing the Social Credit Association witnesses and the Association's counsel made very substantial withdrawals from evidence originally submitted in proof of the gap. Mr Jordan admitted, for example, that *"increases in debts, public and private, are neither a measure of the gap, nor conclusive proof of it"*. He finally went so far as to say that the Association did not *"postulate a chronic shortage of purchasing power"*.

499. Under examination, Mr Young at first placed considerable reliance on certain estimates of the gap published in New Zealand Social Credit literature. Later he admitted that these computations were full of serious errors. Indeed, he even admitted that the computation of a gap of £193·5 million, on the basis of which an issue of debt-free money of some £80 million to £90 million was promised in 1954 by the Social Credit Political League, involved comparisons of 1951–52 production with a total of salaries and wages for 1950–51 and company and other incomes for 1949–50. It is obvious that such a computation is worthless either as proof of a gap, or as a measure of its magnitude.

500. The Association's witnesses and counsel also retreated from the original contention that the banking system's claim to own the credit it dealt in was "a usurpation of the most important and powerful social asset the community possesses". Mr Jordan committed himself to this statement in the final address: *"We do not allege . . . that the banks have usurped the State's prerogative to create money. We allege that they did and had until the passing of the Reserve Bank Act . . . but we can see that nominally at least now the control of money is in the hands of the Government"*.

501. The only positive Social Credit Association proposal for immediate application that was sustained throughout the hearings was that a National Credit Authority should be set up and a national survey made to ascertain, *inter alia,* whether or not a gap existed.

Findings

502. After close examination of the Social Credit submissions and evidence the Commission finds that:

(a) **The Social Credit Association witnesses and counsel were seriously at variance, not only with other social crediters who appeared before us, but also among themselves. They made significant withdrawals in matters of substance; even the A + B theorem was virtually discarded (see paragraph 450).**

(b) **The Association's witnesses presented a distorted picture of the present state of the New Zealand economy and their analysis of New Zealand's existing monetary system was falsely based and seriously erroneous.**

(c) They failed completely to substantiate their original submission that there was a chronic gap between purchasing power and prices (that is, a chronic shortage of purchasing power), which is a fundamental proposition of Social Credit. They withdrew during the hearing from their chief arguments in support of this proposition.

(d) The only positive Social Credit proposal for immediate application sustained throughout the hearings by the Association was that a National Credit Authority should be set up and a national survey made to ascertain, *inter alia,* whether or not a gap existed.

(e) Nevertheless, their whole submission rested on the assumptions that the survey would undoubtedly disclose a gap and that an increase in the volume of money was of itself certain to bring increased production of goods and services.

(f) On the basis of these totally wrong assumptions, they envisaged the application to the existing inflationary situation of remedies devised for a situation of depression, like that of the 1930's on which their theory appears to be founded. They did not allow for the radical change in circumstances since then, and they drew many of their examples of alleged deficiencies in the present economic system from the conditions of twenty-five years ago.

(g) There is abundant proof that New Zealand's present problem is not a shortage of purchasing power, as in the 1930's, but an excess of purchasing power. Nothing in the Social Credit proposal was designed to meet such a situation. When, as now, the resources of the community are already over-stretched, further issues of money will produce nothing except further pressure on the existing supply of goods and services – and consequent higher prices and dissipation of overseas exchange reserves.

(h) If made in the present circumstances, the large issues of debt-free money contemplated by the Association and recommended by other Social Credit witnesses would produce most serious and chronic inflation and gravely disrupt New Zealand's economy.

(i) The admitted ultimate objectives of Social Credit, the abolition of debt and interest and the substitution of a national dividend for the wage and salary system, would necessarily involve the abolition of private ownership of property.

IV. Submission of Mr H. J. Kelliher and the Mirror Publishing Co. Ltd.

Introduction

503. Mr H. J. Kelliher and The Mirror Publishing Co. Ltd. presented six volumes of submissions to the Commission. Many of the matters raised were of a technical nature, including questions of economics, accountancy, and banking. These technical matters have been dealt with in Appendix F. Mr Kelliher did not himself enter the witness box, but evidence was given on his behalf and on behalf of The

Mirror Publishing Co. Ltd. by Mr W. S. Otto. Dr O. C. Mazengarb, Q.C., appeared as counsel for Mr Kelliher and The Mirror Publishing Co. Ltd. The hearing of evidence, examination of the witness, and addresses by counsel occupied nearly twelve days. Wherever we ascribe matter to Mr Kelliher in the report, we are referring to the preliminary documents placed before the Commission, to the prepared submissions, and to the remarks of Mr Kelliher's counsel. Where Mr Otto is mentioned, we refer to his statements under examination, to his written replies to questions put to him during the hearings, and to documents presented in amplification of his evidence.

504. In his submissions, Mr Kelliher diagnosed the chief cause of the inflation in New Zealand as the creation of new money by the banking system in the expansion of its lending and investing operations. He also put forward the view that deflation is caused by the reverse policy of reducing lending and investment. He submitted what he described as *"a new concept in banking technique which will enable the banks to lend and invest without creating or destroying the nation's money supply"* which he called *"Loanable Funds"*. To supplement his main proposal, the Loanable Funds Scheme, he also submitted a number of ancillary proposals, such as schemes for insulation of the New Zealand economy from the effects of overseas price changes, for control of capital investment in New Zealand, for regulation of wage increases, and for a number of other purposes.

Brief Explanation of the Process of Creation and Destruction of Money

505. Preparatory to a discussion of Mr Kelliher's proposals for reform of the banking system, the next few paragraphs explain briefly the terms "money supply", "volume of money", and "creation" and "destruction" of money which are more fully discussed in Section Four of this report and in Section One of Appendix C.

506. The term "money supply" and "volume of money" are synonymous. As defined by the Reserve Bank, they represent the amount of money at any time in the form of coin and bank notes in circulation, and free (or demand) deposits available at the banks to the public or to the Government for spending. It is an essential element of the "money supply" that it represents money which the public (or the Government) has an unqualified right to spend at will. For example, a free deposit is an asset immediately available for spending by the customer who owns it. A fixed deposit is also an asset of the customer who owns it but it has been lodged with the bank for a definite period and is therefore not available for spending until the end of that period. For this reason fixed deposits are excluded from the official definition of the money supply adopted by the Reserve Bank.

507. A bank overdraft is a liability of the customer to whom it has been granted. He is liable to repay any amounts he has drawn, when he is called upon to do so by the bank. Amounts drawn by customers against overdraft accounts play an important part in determining the total amounts held as demand deposits by bank customers. When a customer exercises his right to draw cheques on his overdraft account, such cheques will usually be paid to other people who then lodge the cheques to the credit of their own bank accounts. As the number of

customers' accounts in credit is greatly in excess of the number of overdraft accounts, it may be expected that, in the normal course of business, many cheques drawn on overdraft accounts will be lodged to the credit of accounts which are in credit (i.e., free deposit accounts).

508. By this process an expansion of bank advances on overdraft will usually lead to some increase in the total of free deposits, which form the greater part of the money supply. Similarly, when bank advances are reduced, there may be a reduction in free deposits and therefore in the money supply. These increases and decreases in the money supply are sometimes called "creation" and "destruction" of credit or "creation" and "destruction" of money. The other causes from which similar increases and decreases in the money supply may arise are described in paragraphs 157 to 163 of this report and in Section One of Appendix C.

Claims by Mr Kelliher for the Loanable Funds Scheme

509. Mr Kelliher claimed that his main proposal for banking reform, the Loanable Funds Scheme, would have these principal advantages:

(a) Trading-bank lending and investment transactions would not increase or decrease the money supply. He said: *"What I advocate is a new concept in banking technique, which will enable the banks to lend and invest without creating or destroying the nation's money supply"*. In this way Mr Kelliher claimed that the Loanable Funds Scheme would cure what he described as the *"cardinal defect"* in the existing banking system.

(b) Inflation could be cured without restricting bank lending. In his own words, *"Monetary inflation has been the principal culprit and major cause of price inflation. How then is the situation to be rectified without restricting bank lending for private and business purposes? I have endeavoured to supply the answer"*. Elsewhere Mr Kelliher stated that he advocates a *"more elastic and vastly improved banking technique whereby the trading banks would be enabled to lend from the existing stockpile of money to the limit of credit-worthy borrowing"*.

(c) The trading banks would be prevented from *"destroying the nation's money supply"* in a recession.

(d) The scheme would *"revitalise free enterprise and enable all controls to be dispensed with"*.

(e) The trading banks would *"borrow to lend"* according to the principle *"to which all Savings Banks and other financial institutions must conform"*.

510. The Loanable Funds Scheme would begin on the basis of the level of trading-bank advances existing at the time. Thereafter, in the main, the trading banks would be limited in their authority to make advances by their ability to attract additional fixed deposits or *"savings"* deposits as Mr Kelliher calls them, together with any reduction in the former total of advances. (Full details of the transactions which increase and decrease the ability of the banks to lend under the Loanable Funds Scheme are set out in paragraphs 23 and 24 of Appendix F.)

Demonstration of Creation of Money Under the Existing System

511. As part of his explanation of the Loanable Funds Scheme, Mr Kelliher gave a demonstration of the manner in which the money supply is increased or decreased as a result of trading-bank lending and other transactions. This demonstration was technically correct, and was in line with the brief description of the mechanism of bank lending given above and with the explanation previously supplied to the Commission by the Reserve Bank when the hearings opened.

512. Mr Kelliher placed much emphasis on a statement made by Mr Whyte, Chairman of the Associated Banks, under examination, that in the course of their lending and investment operations the trading banks *"create money"*. Similar statements had been made previously to the Commission by representatives of the Reserve Bank, the Treasury, and the trading banks. As we have pointed out in paragraphs 428 to 431, such statements have appeared in economic text books for the greater part of the present century and, indeed, even before 1900. In the Commission's view Mr Kelliher placed undue emphasis on this characteristic of banking which has existed at least since the times of the goldsmiths and which has been recognised and written about for many years. (See Part II of Appendix D.) Mr Kelliher has attempted unsuccessfully to remove this characteristic by means of the Loanable Funds Scheme.

Special Accounts Introduced by Mr Kelliher: "Bank Demand Deposits Account" and *"Loanable Funds Account"*

513. The Loanable Funds banking technique introduces two new items to the accounts of a trading bank called *"Bank Demand Deposits"* and *"Loanable Funds"*. Mr Kelliher in his submissions explained that the *"Bank Demand Deposits Account"* was *"the repository for New Zealand money acquired by the various methods already referred to"*, as, for instance, the amount transferred by customers from free deposits to fixed deposits, reductions in the total of advances to customers, etc. The *"Loanable Funds Account"* he said was *"the amount of New Zealand money available for lending and investment"*. The former account was treated as a liability and the latter as an asset. Both accounts would always be equal in amount, as one was the counterpart of the other.

514. Under the Loanable Funds banking technique, when a bank increased its loans to customers, the Bank Demand Deposits Account would be debited with the amount of the increase and a corresponding credit would be made in the Loanable Funds Account, thus decreasing the credit balance in Bank Demand Deposits Account and decreasing the debit balance in the Loanable Funds Account. On the other hand, when a bank obtained a transfer by its customers of some of their free deposits to fixed deposits or repayments of previous loans, the Bank Demand Deposits Account would be credited with the total of these transactions and a corresponding debit would be made in the Loanable Funds Account. This entry would increase the credit balance in the Bank Demand Deposits Account, and increase also the debit balance in the Loanable Funds Account.

515. Mr Kelliher made a further and, in our opinion, quite improper use of the Bank Demand Deposits Account by including its balance from time to time in the specimen computations of the money supply he used in his attempt to prove that under his proposals expansion or contraction

of bank lending and investment would not cause any change in the money supply. In doing this he violated the definition of the money supply which he had previously accepted. It is only by this means that he is able to produce an apparent constancy of the money supply under the Loanable Funds Scheme.

516. The Bank Demand Deposits Account would merely show the extent to which a bank may at any time increase its loans or investments. It represents no more than a computation of the additional amount which the banks could lend at any time, but in fact have not lent. Clearly, therefore, the inclusion of Bank Demand Deposits in the measurement of the money supply must produce a result which is fallacious and wholly misleading. We have seen how Bank Demand Deposits Account is expanded by increases in fixed deposits and by repayments of existing advances and is reduced by the actual loans or investments which the bank makes. Under the Loanable Funds proposals, if customers of a bank transferred certain moneys from free deposits to fixed deposits, the Bank Demand Deposits Account would be increased by the amount of the transfer. As the free deposits have been reduced, the amount of money available to the public for immediate spending has been reduced correspondingly, because the fixed deposits are not available for spending. Consequently, there has been a reduction in the money supply. Under the Kelliher Scheme this reduction is countered by the inclusion of Bank Demand Deposits in the money supply.

517. On the other hand, when a bank makes a loan it will usually result in an increase in the money supply. Under the Loanable Funds proposal, the Bank Demand Deposits Account is reduced by the amount of the loan, so that the inclusion of that account again creates an illusion of maintaining a constancy in the money supply when in fact an increase has occurred.

518. *"Bank Demand Deposits"* is a very misleading name for the account which Mr Kelliher sets up, conveying as it does the false impression that the account is similar in nature to the "demand deposits" owned by trading-bank customers and available for spending by them, which comprise the greater part of the money supply.

519. The Bank Demand Deposits Account does not represent deposits payable by the bank to anyone. No one can "demand" repayment of these sums in the same way that bank customers can demand repayment of their deposits. Neither is this account in any sense a liability of the bank or part of the proprietor's interest in the business. It is a memorandum record of the extent to which a bank would be entitled to increase its lending and investment under the Loanable Funds Scheme. Its counterpart on the assets side of the balance sheet, the Loanable Funds Account, is in no sense an asset of the bank. It is merely a double-entry counterpart of the other fictitious item Bank Demand Deposits and is introduced merely to balance the books.

520. If the Bank Demand Deposits Account had been given a name correctly describing its nature, such as "Unused Bank Lending Limit", the error of principle involved in including it in the money supply would have been apparent on the face of the examples submitted by Mr Kelliher. The name *"Bank Demand Deposits"* conceals this error of principle but does not remove it.

521. After examination of Mr Kelliher's main proposal, the Loanable Funds Scheme, the Commission finds that under it the process of increasing bank advances leads to an expansion of the free deposits available for spending by bank customers. The Commission also finds Mr Kelliher's contention that his proposals would result in a stable money supply to be demonstrably false even on the face of the examples submitted in support of his claim.

522. These examples preserve an arithmetical constancy in the money supply, but under examination this apparent constancy is shown to be entirely spurious. As explained above, a constant total has been preserved only by the introduction into Mr Kelliher's computation of the money supply of a fictitious item specially created for the purpose. This fictitious item is not part of the recognised definition of the money supply which Mr Kelliher himself cited previously with approval. It does not represent money available for spending by bank customers. Indeed, as pointed out in paragraph 516, it merely represents the maximum permissible limit, for the time being, to increases in bank lending.

The Meaning of the Term "Money Supply"

523. When he demonstrated that trading-bank transactions under the existing system may increase or decrease the money supply, Mr Kelliher adopted the Reserve Bank's definition of the latter term, but when he purported to show that such increases and decreases in the money supply did not occur under the Loanable Funds Scheme he gave the term "money supply" a different and, in our view, fallacious meaning. Under examination Mr Otto admitted that such a change in definition had been made. When exactly the same reasoning and definition by which he had proved that the trading banks at present create and destroy money was applied to the Loanable Funds examples which Mr Kelliher himself had supplied, it was found that the same increases and decreases in the money supply (or creation or destruction of money) still occurred. This also was admitted by Mr Otto. It is thus clear that the argument by which Mr Kelliher sought to establish that his scheme would prevent trading-bank transactions from increasing or decreasing the money supply is fallacious. The main virtue claimed for the Loanable Funds Scheme is therefore destroyed by the admission of Mr Kelliher's own witness. The *"cardinal defect"* which he alleges in the existing system is thus shown to continue in his own examples of the working of the Loanable Funds Scheme, just as it did in his examples of the existing system. (See Appendix F, paragraphs 39 and 40, for details of the admission referred to above.)

524. Mr Kelliher's contention that inflation could be cured under the Loanable Funds Scheme *"without restricting bank lending for private and business purposes"* is, in our view, without foundation. We have already pointed out that, when bank advances are expanded under the Loanable Funds Scheme, the same increase would occur in the free deposits of customers as might be expected under the existing system. We find nothing in the Loanable Funds Scheme to convince us that such an increase would not have the same inflationary effects as a similar expansion of advances would have under the existing system.

Increases in Fixed Deposits as Main Limit on Trading-bank Lending

525. Under the Loanable Funds Scheme, the limit to which trading banks could extend their advances would be determined mainly by the additional amounts which they could obtain on fixed deposits. The only manner in which advances could be greatly expanded would be through a substantial accession of fixed deposits. Under the scheme the banks would not be restricted in the interest rates they could pay for fixed deposits. We doubt whether the trading banks could induce any worth-while transfer of free to fixed deposits without offering relatively very high interest rates.

526. To the extent that the banks could attract into fixed deposits amounts from time to time standing to the credit of customers' free deposits, they could make increased advances. Where free deposits are lying idle, their attraction into fixed deposits would not of itself justify an expansion of trading-bank advances. Under the Loanable Funds Scheme, as under the existing system, increased advances might be expected to result in increased free deposits, some of which in turn would be placed on fixed deposit if the interest rates offered by the banks were sufficient to attract them. Such a process, which involves the creation of free deposits and therefore of money, would be technically quite possible under the Loanable Funds Scheme. If, as seems unlikely, the trading banks were able to attract a sufficient sum in fixed deposits to enable an expansion of trading-bank lending *"to the limit of credit-worthy borrowing"*, the result would be, in the prevailing circumstances, highly inflationary. A fundamental flaw in Mr Kelliher's argument is that under his scheme a mere change in the terms on which a trading bank borrows money from its customers (i.e., from free deposits, repayable on demand, to fixed deposits, repayable after three, six, or twelve months) is made the justification for expanding trading-bank advances.

527. According to the evidence, unduly high rates of interest would be necessary to enable the trading banks to attract sufficient fixed deposits to permit a worth-while expansion of advances. Payment of unduly high rates of interest would constitute a serious threat to the continued existence of the recognised savings institutions. To the extent that transfers of fixed deposits were achieved, they would permit a pound for pound expansion of trading-bank advances. In our view it would be quite wrong in principle to permit such an expansion of advances especially if, as proposed under the Loanable Funds Scheme, the existing control of trading-bank advances through the reserve ratio system were to be discontinued.

The Money Supply in a Recession

528. As mentioned in paragraph 509 (c), Mr Kelliher claimed that, under the Loanable Funds Scheme, the trading banks would be prevented from *"destroying the nation's money supply"* in a recession. In a time of economic depression business men take action designed to reduce their financial requirements, such as reducing the volume of the stocks they normally carry. This results in a reduction in bank overdrafts and consequently in the money supply. Under the Loanable Funds Scheme a reduction in bank overdrafts would result in an increase of a corresponding amount in the Bank Demand Deposits Account. To suggest that there has been no reduction in the money supply is wrong. The actual reduction in demand deposits of bank

customers is offset in Mr Kelliher's computation by the increase in Bank Demand Deposits. In these circumstances, this increase merely represents authority to lend which the bank is unable to exercise, because either no one wants to borrow, or those who do are not credit worthy.

529. We have pointed out above that in a recession one of the reasons why trading-bank advances decline, with a possible fall in the money supply, is that customers of the banks are no longer willing to borrow to the same extent. Indeed, on past experience, the banks would find their fixed deposits increasing in a recession but would lack sufficient willing and credit-worthy borrowers to enable advances to be maintained. We find nothing in the Loanable Funds Scheme which would prevent bank advances from declining in a recession if bank customers did not wish to borrow or if the trading banks decided to restrict lending.

The Abolition of Controls

530. Mr Kelliher claimed that the Loanable Funds Scheme would *"revitalise free enterprise and enable all controls to be safely dispensed with"*. Among his ancillary proposals, which we discuss at length in Appendix F, there are suggestions which we think would do much to stultify free enterprise and especially capital development rather than to revitalise it. The proposal to restrict the annual capital expenditure of a business to a percentage of its *"shareholders funds"* in our view is a far more rigid and vexatious form of control than the existing Capital Issues control. Mr Kelliher's scheme would apply not only to capital expenditure from moneys raised on the market, but also to any capital expenditure which a business was able to finance from its own resources. A further example is a proposal for compulsory savings under which *"at least 25 per cent should be deducted from the income of every wage earner under twenty-one years of age . . . such savings would be available for drawing only on the attainment of twenty-five years or earlier in the event of marriage or for any other approved purpose"*. **In our opinion Mr Kelliher's scheme would subject the economy to a series of controls more rigid than those which he seeks to remove.**

"Borrowing to Lend"

531. Mr Kelliher cited the present savings-bank system as exemplifying a principle which he called "borrowing to lend", and which he strongly advocated should be applied to the trading banks.

532. It is clear from the submissions that by "borrowing to lend" Mr Kelliher means that, under his scheme, "creation or destruction of money", or increases or decreases in the money supply, would no longer occur through trading-bank lending and investment.

533. Mr Kelliher contended that the Loanable Funds Scheme was *"the most efficient means by which the provision(s) of the nation's money supply may be divorced from the arbitrary lending and investment decisions of hundreds of trading-bank branches throughout the country"*. His proposal was simply *"that the banks should obtain money to lend from the existing stockpile of money, by means readily available to them (which most people think they are doing already), instead of creating new money to lend"*.

534. We have already stated that the Loanable Funds Scheme does not accomplish its primary objective of ensuring that the trading banks will not create and destroy money. The fundamental reason why it fails to achieve this purpose is that it retains the features which enable the existing system to create and destroy money. These features are:

(a) Through the overdraft and cheque systems the trading banks handle the bulk of the commercial transactions of the country and their liabilities, "demand deposits", are used as a customary means of payment and therefore are "money".

(b) Any expansion of bank lending may therefore be expected to result in an increase in the demand deposits of trading-bank customers.

(c) Any contraction of trading-bank lending is likely to lead to a contraction of customers' demand deposits and therefore to a reduction in *"the nation's money supply"*.

535. It is quite clear from the examples of the Loanable Funds Scheme submitted by Mr Kelliher that "arbitrary decisions of hundreds of trading-bank branches throughout the country" would still have the effect of reducing or of increasing the total of customers' deposits, and the *"provision(s) of the nation's money supply"* would therefore *not* be divorced from those decisions.

536. It appears to us that in advocating that trading banks should be required to "borrow to lend" by operating on the same principles as savings banks, Mr Kelliher has overlooked a most important question of principle. Even if the present trading banks were constituted savings banks, provided that they retained the overdraft system and payment by cheque, their deposits at call would then constitute a customary means of payment by bank customers and would therefore qualify for inclusion in the money supply just as demand deposits at the trading banks do now. In those circumstances increased lending by the new "savings banks" would lead to increased "savings-banks" deposits and therefore to the equivalent of increases in the "money supply".

537. These increases would occur whenever savings-bank customers drew cheques on overdraft accounts and paid the cheques to customers who had credit balances in their "savings-bank" accounts, thereby increasing the total of "savings-bank" deposits.

538. The essence of the matter is that where a banking system handles the bulk of the commercial transactions in a country, any expansion of its lending is bound to result in increased deposits somewhere in the banking system. If total demand deposits are increased in this way, there is creation of deposits and therefore creation of money as a result of an increase in advances.

539. The Loanable Funds Scheme does not embody any *"principle to which all savings banks and other financial institutions must conform by prescription of law"*, which would prevent the creation and destruction of money. As we have explained, the creation and destruction of money is inherent in the nature of trading-bank transactions, even under the Loanable Funds Scheme where creation and destruction of money still occurs, but is concealed by the devices we have explained.

540. What the Loanable Funds Scheme does is to place a variable upper limit on trading-bank lending, but it certainly does not enable or require the trading banks to "borrow to lend" in the sense of eliminating

the fundamental features of the present banking system through the operation of which creation and destruction of deposits and money take place.

Legality of Trading-bank Operations

541. Mr Kelliher's contention that the trading banks are operating illegally is dealt with in the previous part of this section of the report and in Part I of Appendix D. As already stated, after a review of all the evidence and argument for and against this contention, the Commission rejects it.

Ancillary Schemes

542. We have dealt in Appendix F and at other places in this report with certain ancillary proposals submitted by Mr Kelliher for use in conjunction with his Loanable Funds Scheme. Our examination of his proposals for the insulation of the New Zealand economy, for the control of capital investment, and for the control of wage increases according to increases in productivity convinces us that they are entirely impracticable for the reasons we give in the appendix. In some instances their operation would be quite inequitable in its effects on different sections of the community.

Comments on Loanable Funds Scheme

543. From the foregoing it should be clear that, in our view, the principal claims made by Mr Kelliher for his Loanable Funds Scheme have not been sustained. We are satisfied that the scheme would not make any fundamental change in the nature of trading-bank transactions. Neither would it alter the inflationary or deflationary effects of an expansion or a contraction of bank lending. All it would accomplish is to impose a somewhat arbitrary upper limit on increases in trading-bank lending, mainly by restricting such increases to the extent to which the banks are able to attract additional fixed deposits.

544. We are satisfied that the mere increase or decrease of fixed deposits is not a satisfactory criterion of the extent to which it may be desirable or necessary to expand or contract trading-bank advances. Judged by the evidence given by Mr Fussell and Mr Whyte, there is considerable reluctance on the part of holders of free deposits at trading banks to invest such deposits for fixed periods, even to earn interest. If this remained so in the future, the scheme could prove far too rigid to enable the trading banks to meet the necessary requirements of trade and industry in an expanding economy. It was apparent that Mr Kelliher envisaged such a possibility, since he included in his submissions a suggestion that in such circumstances the trading banks could be assisted by loans from the Reserve Bank or by other Reserve Bank operations. Assistance in this form would result in the creation of new and additional money.

Conclusion

545. We acknowledge the high sense of public duty which prompted Mr Kelliher to make his submissions and the great industry shown in the detail in which they were compiled. Our conclusions on the submissions are summarised as follows:

(a) In his analysis of the economic system Mr Kelliher greatly exaggerates the effects of increases in the money supply and especially of trading-bank advances as causes of increases in the New Zealand price level.

(b) The claim that trading-bank lending and investment transactions under the Loanable Funds Scheme would not result in increases and decreases in the money supply or in the creation and destruction of money is not sustained. Neither is the related claim that under Mr Kelliher's scheme the trading banks would *"borrow to lend"*.

(c) Apart from certain open market operations, which we do not consider would be effective, there is no provision in the Loanable Funds Scheme by which an inflationary situation could be remedied *"without restricting bank lending for private and business purposes"*. If trading-bank lending was expanded as Mr Kelliher proposed *"to the limit of credit-worthy borrowing"*, the result in present circumstances would be highly inflationary.

(d) Under the Loanable Funds Scheme, contraction of trading-bank credit in a recession would have the same effect on the money available for spending by the public as it would have under the existing system.

(e) The principal criterion for future increases in bank lending (i.e., increases in fixed deposits) is unsound in principle and, in our view, would be likely to prove far too rigid in practice to enable the trading banks to meet the needs of trade and industry in an expanding economy.

(f) The contention that the trading banks are operating illegally in conducting their lending and investment operations as they do is rejected.

(g) The Loanable Funds Scheme would not *"enable all controls to be dispensed with"*. Indeed adoption of the ancillary proposals put forward by Mr Kelliher would substitute a number of more rigid controls in place of certain existing controls.

(h) In our view the ancillary schemes submitted by Mr Kelliher in support of his Loanable Funds Scheme contain many impracticable features and would have highly inequitable results, even if they could be operated.

546. In the light of the foregoing conclusions we are completely convinced that the Loanable Funds Scheme should not be adopted. Nor do we recommend adoption of the ancillary schemes for insulation of the New Zealand economy, for control of capital investment, and for regulation of wage increases.

V. Commodity Currency Proposals

547. Mr Colin Clark, M.A., Director of the Institute of Agricultural Economics, Oxford, England, and formerly Economic Adviser to the Government of Queensland, who was visiting New Zealand, was invited to give evidence. He advanced proposals for stabilising the value of the currency by backing it not by gold, but by stocks of commodities. A

scheme similar in basic principles was advanced by Mr A. N. Field, of Nelson. Mr I. W. Weston, of Christchurch, advocated the adoption of a commodity currency scheme on an international basis.

548. Details of the schemes suggested are included in Appendix G to this report, which also contains an analysis of the proposals and some relevant comments from a United Nations publication dealing with the same subject.

549. For the reasons set out in full in paragraphs 23 and 24 of Appendix G we do not recommend the adoption of these proposals.

Section Nine

COMMISSION'S VIEWS ON REFORM AND COMMENTS ON PROPOSALS FOR REFORM

Introduction

550. In the previous section and in Appendices E, F, and G we comment on certain major submissions made to us. In this section we examine further submissions and discuss a variety of proposals for reform of particular aspects of the monetary, banking, and credit systems.

I. Recommendations for Improvements in the System of Controlling Bank Credit

551. If a system of control of bank credit is to be reasonably effective, we believe that it should satisfy the following criteria:

(a) The monetary authorities should make an estimate of the trend of bank credit which is likely to be in the best interests of the country in the months ahead.

(b) The trading banks should be consulted in the preparation of such an estimate and be promptly and fully informed of the decisions eventually made by the authorities as to the desirable trend of bank credit.

(c) The trading banks should be given a direct financial incentive to co-operate with the credit policy decided upon by the authorities.

(d) The system should be as direct and as simple in operation as possible, so that the implications of changes in credit policy may be made clear to the general public.

(e) It should be capable of prompt adjustment to meet changing circumstances.

(f) It should allow for competition for business among the trading banks.

552. As indicated in Section Seven of this report, the authorities responsible for administering the present system of variable minimum reserve requirements, based on the demand and time deposits of the trading banks, have not succeeded in recent years in preventing an undesirably large expansion of trading-bank credit. However, we consider that their lack of success has been primarily due not to inherent defects in the system of control, but rather to defects in the administration of the system. Most of the above criteria could be satisfied through the existing reserve ratio method of control, supplemented by appropriate Government action in other spheres.

553. One of the major faults in administration by the monetary authorities in recent years would seem to have been failure to set any clear and definite objectives of policy.

554. The Governor of the Reserve Bank said in evidence that there was no means of deciding in advance what the volume of money should be at a given date. While acknowledging the difficulties of reaching such a decision we consider that the monetary authorities, if they are to have a policy at all, must make some attempt to estimate what the volume of money should be and, therefore, also to estimate what would be desirable levels of bank credit for different periods of the year ahead.

555. In the sections of this report dealing with statistics, economic research, and forward exchange, we make suggestions which should help to overcome some of the difficulties involved in estimating desirable levels of bank credit (and in fixing appropriate reserve ratios).

556. If the trading banks were consulted in preparing the estimate of the desirable levels of credit for the months ahead, and were fully informed of the credit policy decided upon by the authorities, they would have no justification for substantially expanding advances in the light of unexpected increases in their cash reserves even if the reserve ratios were not immediately raised. In the past, because of the lack of any clearly-formulated objectives, and tardiness by the authorities in raising the ratios to offset increases in bankers' cash, advances have been allowed to rise to totals which, too late, were seen to be too high. Once advances have expanded unduly, as we point out later, it is difficult to reduce them quickly without causing some dislocation of economic activity. Constant review of the level of bank credit and of the money supply would help to obviate the need for sudden changes of policy to check excessive expansion of spending or any undue contraction of spending. Such sudden changes must necessarily cause inconvenience and some hardship.

557. The minimum reserve ratio system cannot be relied upon to provide automatically a direct financial deterrent to the trading banks against deviation from the credit policy of the authorities or a direct financial incentive to co-operate with their policy. However, it could be used deliberately to provide such financial deterrents or incentives.

558. The banks are not automatically penalised if they are forced to borrow from the Reserve Bank to maintain their statutory reserve requirements as a result of an expansion of their advances. This is so even if the minimum reserve ratios are fairly high and the rate of interest charged to the banks by the Reserve Bank is higher than the rate of interest which the banks can obtain on their advances. The simplified example at the end of this section shows that an expansion of advances by the banking system as a whole of £10 million, not desired by the authorities, would be profitable to the banks even if the minimum reserve requirement were 25 per cent of the banks' demand deposits, and the Reserve Bank's lending rate were 6 per cent as against an average rate of interest of 5 per cent earned by the banks on advances. In these circumstances, after allowing for a loss of the banks' reserve balances of £3 million to buy extra overseas exchange for their customers (who can be expected to spend more on imports if advances increase), the banks' indebtedness to the Reserve Bank would increase

by only £4¾ million (at 6 per cent), as against the expansion of advances of £10 million (at 5 per cent). Their gross profit, after payment of interest to the Reserve Bank, would be £215,000 and it is most unlikely that any consequential increase in their administrative expenses would approach this sum. Even if the Reserve Bank charged the banks 7 per cent, they would still not be financially penalised.

559. It should be made clear that this example refers to an expansion of advances by the banking system as a whole with all the banks keeping in step in their lending policies. If, on the other hand, one bank which was just meeting its minimum reserve requirement expanded its lending by £10 million while the lending of the other banks was not increased, it would certainly be penalised. As explained earlier, it would lose large amounts of cash to the other banks, and would be forced to borrow heavily from the Reserve Bank to maintain its required reserve.

560. Thus, the banking system as a whole is not automatically penalised when an unwanted expansion of advances occurs. Further examples could be given to show that even fairly high reserve requirements and lending rates do not automatically provide a sufficient penalty to bring about a reduction of excessive advances.

561. However, the existing system could be used to provide a direct financial deterrent to an unwanted expansion of advances or a direct financial inducement to the banks to reduce advances from a level which was deemed too high. The pre-requisites are that the banks should be fully informed of the credit policy of the authorities and that the authorities should be prepared to act speedily and resolutely to ensure that their policy is implemented. The authorities would require to set target levels of bank credit for certain dates in the months ahead. The banks would then be informed that, for every £1 million by which advances exceeded the target level fixed for a particular date, the ratios would be raised to put the banks into debt at the Reserve Bank to the extent of £1 million. To avoid unduly conservative lending policies by the banks, it might be desirable to fix two rates of interest for borrowing from the Reserve Bank. One would apply to extensions of credit slightly above the desired level and would be fixed at such a figure that the banks made neither profit nor loss by expanding credit to that extent. The other, a penal rate, would be applied after this margin of tolerance had been exceeded.

562. The target levels of credit for later months would need to be revised from time to time in the light of changing circumstances. If, through no fault of the banks, circumstances altered so that the then level of credit was deemed excessive by the monetary authorities, we would envisage consultation with the trading banks on a planned programme of reduction. Having decided on such a programme, the Reserve Bank would serve notice to the trading banks that the ratios would be altered in future so that credit above the levels which it had been decided should be attained on given dates, would be unprofitable to the banks. If an expansion of credit were desired, the ratios and the rate of interest charged would, of course, be lowered.

563. We contemplate frequent changes of the ratios to allow for changes, expected or unexpected, in the level of the bankers' cash, so that the banks would be neither unnecessarily penalised, nor permitted

to hold excessive amounts of free cash. These changes should not be disturbing to the banks, provided that they were fully informed of the target levels of credit set by the authorities. If there were a large increase in bankers' cash (e.g., as a result of a balance of payments surplus), it might be necessary, in the public interest, to raise the reserve requirements to a very high ratio in order to prevent an undesirable expansion of bank credit by several times the increase in bankers' cash.

564. Any system of control would limit the freedom of action of the banks, but experience has shown that the total of advances must be controlled in the public interest to prevent the aggravation of inflationary or deflationary tendencies. Such control, incidentally, would add to the long-term strength and flexibility of the banking system as a whole.

565. It was suggested by the Associated Banks that the power of the Reserve Bank to vary the statutory minimum reserve ratios should be restricted by making amendments to the Reserve Bank Act to empower the Reserve Bank merely to require the trading banks to maintain statutory deposits varying between a minimum of 7 per cent of demand and 3 per cent of time liabilities and a maximum of 25 per cent of demand and 12½ per cent of time liabilities. In making this suggestion the Associated Banks explained that they had in mind, "*that the circumstances which might justify a higher ratio would be sufficiently serious to need full discussion by Parliament*".

566. We see no justification for restricting the power of the monetary authorities to fix such reserve ratios (above the minimum of 7 per cent of demand deposits and 3 per cent of time deposits at present fixed by law) as they may deem necessary in the public interest.

567. We suggest that, dependent on the circumstances existing at the time, some compensation might be given to the banks if it became necessary to raise the reserve ratios to very high levels. Presumably the necessity for such action would usually be due to a considerable expansion of bankers' cash (e.g., as a result of persistent surpluses in the balance of payments) which would be accompanied by an expansion of customers' deposits. If, in such circumstances, the banks' administrative expenses were to rise, and if they were to be prevented in the public interest from expanding their advances, it might then be equitable to allow them to earn some income from at least part of their frozen balances at the Reserve Bank. This could be done either by paying interest on some of these balances or by permitting the banks to take up Treasury bills already held by the Reserve Bank. Neither of these courses would add to the existing supply of money.

568. The existing reserve ratio system is not the only method which could be used to control bank credit. The Reserve Bank suggested to the Commission that the reserve ratio system should be modified as follows:

Instead of the trading banks' minimum balances at the Reserve Bank being related to their demand and time liabilities, it is proposed that—

(a) The whole of bankers' cash in New Zealand be included, i.e. notes and coin in addition to balances at the Reserve Bank;

(b) That minimum cash be related to advances, discounts and securities.

569. The above scheme has two main advantages over the existing system:

(a) The proposal that notes and coin be included in the calculation of the ratio partly overcomes a difficulty which arises from the fact that, because of differences in the type of business which they handle, different banks require to hold different proportions of notes and coin. Consequently, under the existing system, although two banks may each hold the same proportion of their customers' deposits in notes, coin, and balances at the Reserve Bank, one may be forced to borrow from the Reserve Bank at a given ratio because it has to keep large working balances of notes while the other, with most of its liquid assets in the form of balances at the Reserve Bank, need not borrow at all. If the suggestion that notes and coin be included is adopted, we see no reason why the present arrangement under which the Bank of New Zealand can borrow certain amounts free of interest from the Reserve Bank should be retained.

(b) The Reserve Bank proposal relates the minimum cash requirement more directly than at present to the credit which it is desired to control, and thus penalises the banks more directly for an unwanted expansion. Nevertheless, as with the existing system, it does not automatically satisfy the criteria set out at the beginning of this section, and, to be effective, it would have to be operated in conjunction with the suggestions made above, as to setting target levels of credit and providing appropriate inducements and deterrents to the banks.

570. As an alternative to the variation of reserve ratios, the Government could amend the banking legislation to permit the Reserve Bank to charge the banks interest directly on any credit extended in excess of a level previously determined. The total credit which the authorities thought desirable during, say, each quarter, could be allocated among the banks in proportion to the notes, coin, and balances at the Reserve Bank which each held at selected dates. This suggestion departs more radically from accepted central banking practice than the other suggestions made above, but it has the virtue of being relatively simple and direct in operation.

571. In the Commission's view, any of the three courses suggested above could be used as a reasonably effective method of control of bank credit and are recommended for consideration by the monetary authorities, that is:

(a) The present system of reserve ratios, whereby the banks have to maintain balances at the Reserve Bank equal to stipulated proportions of their customers' demand and time deposits.

(b) The Reserve Bank's suggestion that the banks be required to keep notes, coin, and balances at the Reserve Bank equal in total to stipulated proportions of the total of their advances, discounts, and investments.

(c) A system whereby the banks were charged interest directly on the amount by which their advances, discounts, and investments exceeded a figure previously determined as desirable.

In all cases, however, it would be essential to fix target levels of credit, and to provide appropriate penalties and rewards to induce

the banks to co-operate with the policy of the authorities. The Government should also ensure that its budgetary, interest rate, and other policies are as far as possible consistent with its credit-control policy.

Overdraft Interest Rates

572. In another part of this report we recommend that greater use should be made of changes in interest rates as a part of monetary policy than has been the case in recent years. The same recommendation applies to bank overdraft rates.

573. For reasons given in the part of the report we have just referred to, we do not advocate that overdraft rates should be completely freed from control in present circumstances, but we are of opinion that the banks should be free to vary their interest rates within a wider range than the 4 to 5 per cent as at the time of writing. **We therefore recommend that the banks be permitted to fix rates of interest charged on overdrafts within a fairly wide range, on the understanding that the average rate of interest charged will not exceed a figure deemed desirable in the circumstances.**

[Since this section of the report was written, the Government has adopted a policy along the foregoing lines.]

574. In making this suggestion, we would emphasise that it is merely part of a co-ordinated programme to bring inflation under control. Higher overdraft rates have a part to play in such a programme, in that they may reduce spending by deterring some people or firms from borrowing from the banks. The higher fixed deposit rates which we envisage would accompany the higher overdraft rates might also induce some people to refrain from spending. We doubt the possibility of achieving any large reduction of bank advances by changes in the overdraft rate alone, especially when the demand for bank credit is high, because borrowing from the banks is convenient and relatively inexpensive and there are few alternative sources of credit available. Increases in the overdraft rate must therefore be accompanied by a firm advance control policy, embodying a financial encouragement to the banks to reduce advances to a desirable level. Adequate supporting policies in other fields are also necessary to spread the necessary reduction of spending as widely as possible.

575. Our remarks are made against a background of inflationary pressure, but should the occasion arise when some stimulation of spending is necessary, we believe that lower overdraft interest rates can contribute to a co-ordinated programme of expansion.

Selective Advance Control

576. In an inflationary situation, it is desirable that the credit available should, as far as possible, be channelled into those industries which are deemed essential in the national interest. We agree with the contention of Mr Ashwin, Mr Fussell, and Mr Whyte that, in such a situation, the policy of selective advance control should be retained. We suggest that it might be strengthened if some use were made of a financial deterrent to the expansion of less essential industries. **Accordingly, in making our recommendation that the trading banks might fix overdraft rates within a wider range, we have in mind that they might be requested by the**

Government to charge higher rates of interest for loans to borrowers in the least essential categories in accordance with the selective control policy.[1]

577. If and when a period of reasonable stability is reached, consideration should be given to the removal of control of interest rates and of selective advance control.

Control of Purchase of Investments by the Trading Banks

578. If the mechanism for the control of bank credit is effective, we can see no reason why the banks should not be left free to choose the form in which they will hold their interest-earning assets. On the assumption that an efficient system of control is introduced to hold total bank credit (advances, discounts, and investments) at the level deemed to be in the national interest, we therefore recommend that the banks should no longer be prevented from investing in Government securities.

Some Difficulties of Control Through the Reserve Ratio System

579. In addition to the problems mentioned above, there are other practical difficulties involved in the application of a reserve ratio system to which attention must be given.

580. Difficulties arise in fixing a ratio which will impose a suitable degree of restraint on the banks in the existing circumstances because the cash reserves, deposits, and advances of the banks change frequently in response to variations in external trade and as a reaction to the impact of Government finance, both over long periods and seasonally. For example, in March when income-tax payments are made, there is invariably a rise in bank advances and a drain of cash from the banks to the Government, as customers' deposits are drawn upon to meet their tax obligations. It is inevitably difficult to predict the timing and extent of changes in the balance of payments and in the Government's cash position.

581. The suggestions made in this report on forward exchange should assist in forecasting changes in the balance of payments.

582. The difficulties which arise in respect of tax payments in March would be reduced to some extent by the introduction of a system of pay-as-you-earn taxation. The staggering of payments of taxes by companies and farmers over the year would also assist.

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(1) The Government might, for example, arrange with the banks that the average rate of interest charged on overdrafts should not exceed 5 per cent. But the banks might be asked to charge only 4 per cent for advances for purposes deemed of major national importance, e.g., to farmers for purposes likely to increase primary production, or to manufacturing firms which might expand the economic production of goods of a type which must currently be imported. Advances would, of course, be made only for purposes for which bank credit might properly be used. On the other hand, the banks might be asked to charge, say, even as high as 10 per cent for advances for purposes which the government wished to discourage in the circumstances. It should be understood that there are inherent limitations in any policy of selective advance control, in that the banks cannot police the use of the advances which are granted for particular purposes. Nevertheless, higher overdraft rates, judiciously applied, should restrain at least some less essential expenditure.

583. Finally, although it would be unrealistic to expect that existing overdraft authorities should not be used for the payment of taxation, those responsible for monetary policy should give no encouragement to the extension of overdrafts purely for this purpose, especially in inflationary circumstances. Nor should overdrafts be extended to enable people to contribute to Government loans.

Different Types of Banking Business

584. Because they have different types of customers, the trading banks do not have a uniform pattern of business throughout the year. For example, banks which finance a large part of meat exports may experience a marked seasonal upsurge of advances and loss of bankers' cash which is not shared by other banks. This is a problem which would have to be faced under any system of control. But many businesses have to make provision for seasonal variations in their operations, and we see no reason why special concessions should be made on such grounds under a policy of credit control.

Varying Margins of Free Cash

585. At certain times difficulties arise in the application of the reserve ratio system of control because no uniform minimum ratio affects the banks equally. To provide an effective deterrent to expansion of advances by the banks it might be necessary to put some banks considerably into debt with the Reserve Bank while others, which hold a greater margin of free cash, might not need to borrow at all. In our opinion while this was undoubtedly a problem in the early post-war period its importance can be exaggerated in existing circumstances. Difficulties may arise in the short run. If, however, the ratio system were resolutely applied, the difficulties would eventually be overcome as those banks with free cash accepted new business and those borrowing from the Reserve Bank were forced to restrict advances.

586. Any uniform method of control must affect the banks unequally. The main question is whether the control is effective in bringing about a desired level of credit for the banks as a whole, and achieves as equitable a distribution of business as possible among the banks. If the problem of varying margins of free cash is regarded as serious, it might be overcome by fixing a different ratio for each bank. As a general rule, however, we would not favour such a suggestion on the following grounds:

(a) In order to decide what was an equitable ratio to fix for each bank, the Reserve Bank would have to make continuous and detailed investigations into the business of individual banks.
(b) Each variation of the ratios would lead to charges of unfair discrimination from banks subjected to higher ratios than their competitors.

587. Nevertheless, if credit policy were being frustrated by the fact that the policy of a particular bank was out of line with that of its competitors, there might be no alternative but to introduce differential ratios. An amendment of the Reserve Bank legislation would probably be necessary to permit differential treatment.

Frequent Changes of the Ratios

588. If the reserve ratio system of control is to work effectively under New Zealand conditions, frequent changes of the ratios are necessary to keep adequate but not excessive pressure on the banks to maintain or achieve the desired level of credit. The trading banks have complained that frequent changes of the ratios make it difficult for them to plan their operations. This would be so only if the banks had been given no indication by the Reserve Bank of what it regarded as a desirable level of bank credit. Changes in the ratios do not necessarily indicate changes in the severity of the restraint being imposed on the banks.

Lack of Securities as Collateral for Loans from the Reserve Bank

589. There are difficulties in putting the banks very deeply into debt with the Reserve Bank. These difficulties arise primarily as a result of Government policy, in that the banks' holdings of securities which are acceptable to the Reserve Bank as collateral, are small. This difficulty could be met, even under the existing legislation, because the Reserve Bank Act enables the bank to make unsecured loans provided permission is granted by Order in Council. The difficulty would disappear if the banks were penalised directly on credit in excess of a predetermined level, as suggested in paragraph 570 above, and would be lessened if the banks were able to increase their holdings of securities as a result of the adoption of the proposal in paragraph 578.

Unexercised Overdraft Authorities

590. At any period there remains in existence at the disposal of customers of the banks a large volume of unexercised overdraft authorities. During the calendar year 1955, these totalled between £90 million and £120 million. The importance to monetary policy of the existence of these unexercised authorities is that, when credit is tightened, those with unexercised authorities may not immediately be affected and the reduction of advances may well take a considerable time to achieve. In other words, although a policy of credit control may be having a considerable effect in reducing limits, advances may continue to rise.

591. The following table re-constructed from a statement by the Reserve Bank on this question, brings out the importance of unexercised authorities. The table shows advances as a percentage of advances plus unexercised authorities, for each of the banks and for all banks combined, in March over several years.

(Percentages)

March	A	B	C	D	E	All Banks Combined
1939 ..	68·0	75·5	70·8	69·4	65·7	69·9
1950 ..	56·5	63·6	68·2	60·1	64·1	61·7
1952 ..	69·7	76·2	74·9	75·4	81·5	73·7
1953 ..	60·6	63·4	62·8	63·6	61·2	62·1
1954 ..	58·6	59·1	57·0	58·9	59·1	58·4
1955 ..	65·6	69·0	60·4	67·3	64·3	65·1

592. The Reserve Bank commented as follows on this information:

While it is obvious that *all* unexercised authorities will not be used simultaneously, the table shows that the percentage of limits used has varied between 57 and 81 per cent, with a "normal" range of 59 to 75 per cent. A change of 10 points in this percentage can easily happen – and that means £28 million of advances. The fact that between March 1954 and March 1955 the percentage increased from 58·4 to 65·1 accounts for £17 million of the increase in advances during that year. The banks had no control over that increase. Obviously the unexercised overdraft authorities are very important, and limit the effectiveness of ratio policy.

593. In our view, it is important that, in the public interest, the trading banks should keep a close watch on the volume of unexercised overdraft authorities and from time to time review limits which appear unreasonable and unnecessary according to the circumstances and to the use that has been made of them.

Difficulties in Inducing a Desired Expansion or Contraction of Advances

594. The power of the monetary authorities to restrict trading-bank advances in a period of inflation is much greater than their power to induce an expansion of advances, should business activity fall off. The main reason for this is that trading banks cannot expand their lending if there are not enough credit-worthy customers willing to borrow. During a recession, when business confidence is low, this may well be the case. In such circumstances, the Government must itself take steps to stimulate economic activity and restore confidence.

595. There are also difficulties involved in reducing advances quickly, especially in a period of appreciable inflationary pressure. This is so, not only because of pressure on the banks by large numbers of apparently credit-worthy customers at such a time, and because of the existence of a considerable volume of unexercised overdraft authorities, but also because there is a limit to the speed at which customers can reasonably be expected to repay advances upon which they have come to rely. The Commission gained the impression from the evidence of the Governor of the Reserve Bank that undue weight had been given, in the past two years particularly, to the dangers of "*putting the economy into a skid*". But we agree that undesirable disruption might be caused by an attempt to force traders to sacrifice stocks too quickly or to take any other precipitate action to obtain finance for repayment of bank advances. In any case, the first result might merely be to pass to other firms the pressure exerted by the banks. For example, those affected might merely defer payment of their accounts, thus in many cases forcing their creditors to make greater use of their own overdraft limits. Alternative sources of finance are not readily available and for larger firms the position is complicated at present by the fact that the Capital Issues Committee will not usually permit issues of capital for the purpose of reducing overdrafts. Elsewhere in this report we recommend a change in this policy.

596. Thus, although monetary measures have the advantage that they may be adjusted quickly in the face of changing circumstances, they cannot always be expected to produce the desired results quickly. The authorities should therefore keep a constant watch on the level of bank credit and the money supply, and take prompt action to prevent, as far as possible, expansions and contractions which may lead to difficulty in the future. Any system of control of credit must depend for its success

mainly on good judgment, timely action, and resolute and skilful administration by the authorities, for which, in our opinion, there is no real substitute.

Summary of Opinions and Recommendations

597. We summarise our views as follows:

(a) In consultation with the trading banks the monetary authorities should try to assess the levels of bank credit which are likely to be in the best interests of the country in the months ahead, should inform the trading banks promptly and clearly of the credit policy decided upon, and should give them a direct financial incentive to co-operate in this policy.

(b) The policy should be as direct and simple in operation as possible and should be capable of prompt adjustment to meet changing circumstances. It should allow for competition among the banks for business. The public should be fully informed of the current policy and the means being used to carry it out.

(c) Several different methods of control could be used to implement these principles. However, no reserve ratio system will automatically provide the banks with a financial incentive to co-operate with the policy of the authorities, who must be prepared to vary the minimum reserve requirements quickly and resolutely in order to make them effective.

(d) No limit should be placed on the power of the authorities to raise these requirements to whatever level is deemed necessary in the public interest. But, if reserve requirements are fixed at very high levels, it might sometimes be equitable to allow the banks interest on part of the balance which they are required to keep at the Reserve Bank, or to permit them to take up Treasury bills held by the Reserve Bank.

(e) More use should be made of changes in bank overdraft interest rates as an aid to credit policy. The banks should be permitted to fix rates of interest on overdrafts within a fairly wide range, on the understanding that the average rate of interest charged will be at a level deemed desirable by the authorities.

(f) The banks should be requested to use this right to fix overdraft rates within a wider range in such a way as to strengthen the selective advance control policy, which we recommend should be retained while inflationary circumstances prevail.

(g) If an effective system of control of total bank credit (advances, discount, and investments) is adopted, the banks should be allowed to invest in Government securities.

(h) For reasons given above, the operation of the ratio system of control would be improved if:

(i) Notes and coin held by banks were included together with the balances at the Reserve Bank for the purpose of meeting the minimum reserve requirements.

(ii) Fluctuations in bankers' cash were reduced by the introduction of a system of pay-as-you-earn taxation and the staggering of payment of taxes by companies and farmers.

(iii) The trading banks were from time to time to examine existing overdraft limits critically with a view to eliminating those considered unnecessary.

(i) Successful use of monetary policy requires considerable skill and judgment by the authorities. In a country like New Zealand, which is especially subject to disturbances arising from external trade as well as to the disturbances which arise from technical change and changes in the mood of business and consumers, it is essential that policy should be flexible. Adjustments should be made promptly, either to meet changing circumstances, or if the authorities find that they have previously made an incorrect diagnosis. A change of monetary policy is not a sign of weakness, but a sign of increased knowledge and alert appreciation of changing conditions.

NOTE (refer paragraph 558)—The following example shows that the banking system as a whole is not automatically penalised, under the existing method of control, by being forced to borrow from the Reserve Bank as a result of an expansion of advances regarded with disapproval by the authorities, even if the reserve requirements are fairly high and the rate of interest charged by the Reserve Bank for borrowing by the trading banks is higher than that earned by the banks on their advances.

For the purpose of this example, we assume that:

(a) The banks are required to keep a minimum balance at the Reserve Bank equal to 25 per cent of their customers' demand deposits. (The requirement in respect of time deposits is ignored in the interests of simplicity.)
(b) The interest rate charged by the Reserve Bank for borrowing by the banks is 6 per cent.
(c) The banks can earn an average rate of 5 per cent on advances.
(d) Advances are £160 million, a level deemed desirable by the authorities.
(e) Demand deposits are £200 million, so that—
(f) The banks are required to keep a balance at the Reserve Bank of £50 million (25 per cent of £200 million).
(g) The banks can just meet this requirement without borrowing from the Reserve Bank.
(h) If advances expand by £10 million, the demand for overseas exchange by customers to buy imports will rise by £3 million.

Then, if an expansion of advances of £10 million occurs, the banks may lose balances at the Reserve Bank of £3 million to buy overseas exchange for their customers. The remaining £7 million return to the banks as demand deposits.

Thus, as a result of the expansion of advances:

(a) Demand deposits rise to £207 million.
(b) The banks' balances at the Reserve Bank fall to £47 million.
(c) The minimum balance which they must keep at the Reserve Bank rises to £51¾ million (25 per cent of £207 million).
(d) To satisfy this requirement, they must borrow £4¾ million from the Reserve Bank at 6 per cent.
(e) This will cost them £285,000 per annum.
(f) But their increased earnings on the extra £10 million of advances will be £500,000 per annum.

The increased earnings of advances exceed the cost of borrowing from the Reserve Bank by £215,000 per annum. Even if the interest rate charged by the Reserve Bank had been 7 per cent, the increased earnings from advances would have exceeded the cost of borrowing from the Reserve Bank by £167,500 per annum.

It is most unlikely that, in either case, the administrative costs of the trading banks would rise sufficiently to make the net result of the transaction unprofitable.

(N.B.—This example refers not to the operations of an individual bank, but to an expansion of advances by the banking system as a whole, with all the banks keeping in step in their lending policies.)

II. Trading-bank Profits in New Zealand

598. The evidence of a number of witnesses disclosed an uneasiness about the extent of the profits of the trading banks. This was apparently based upon the belief:

(a) That the accounts of the trading banks do not disclose the full extent of their profits because undisclosed reserves are created before the published profits are determined.

(b) The trading banks constitute a quasi-public utility and their profits should therefore be kept within reasonable bounds in the public interest.

599. In the light of this evidence and of the fact that the views expressed appeared to be widely held, we obtained from the trading banks in strict confidence the following information in respect of their New Zealand business as a group for each of the years 1943 to 1954, the latter being the latest year for which the information was available:

(a) The income returned for income-tax purposes.
(b) The taxes paid in respect of such income.
(c) Any non-taxable gains including capital gains.
(d) The total amount of the shareholders' funds employed.

600. After carefully examining the foregoing information we are satisfied that the profits of the trading banks were reasonable during the above period.

601. Nevertheless, because of the apparent uneasiness of a considerable section of the public in regard to bank profits and because of the advisability of inducing the utmost public confidence in the administration of the trading-bank system, we recommend that the Government should take power forthwith to enable it to investigate the profits of the trading banks, if at any time in the future such a course appears to be advisable in the public interest.

602. The Government by virtue of its ownership of the Bank of New Zealand is in a position to inform itself on the general trend of trading-bank profits as evidenced by its experience with its own bank, and so to determine whether a complete investigation of bank profits would appear to be warranted.

III. Charges Made by Trading Banks in New Zealand

603. In New Zealand the trading banks make a charge, termed inland exchange, for the collection of a cheque drawn upon a bank situated in a different centre from the collecting bank. It was represented to the

Commission that the abolition of this charge would represent a considerable saving in expense to the community, particularly as the operations of many businesses are spread over a considerable part of the country. Frequently, elaborate and costly methods are adopted in order to avoid the costs of inland exchange.

604. It should be pointed out that in New Zealand it is the custom of the collecting bank to credit its customer with the proceeds of a cheque when it is lodged for collection, which is sometimes a number of days before the amount is received by the collecting bank. In some countries where inland exchange is not levied we are advised that the custom is not to credit the amount of the cheque to the account of the depositor until the proceeds have been received by the collecting bank. The practice adopted in New Zealand can often result in a considerable saving in interest charges to customers who are operating on overdraft.

605. Another aspect in which banking practice in New Zealand differs from that in some other countries (including the United Kingdom and the United States of America) is the basis of the annual charge for keeping the customer's account. In New Zealand a standard charge of 10s. per half year is made for each account regardless of the amount of work involved in keeping the account. In some other countries the charge is based upon the number of entries involved in keeping the customer's account.

606. To some extent, inland exchange and the charge for keeping accounts are related. Both represent charges made in respect of items passing through customers' accounts.

607. Our investigation of these matters brings us to the following conclusions:

(a) The abolition of inland exchange would mean a considerable saving in time and expense to the community.

(b) A considerable portion of the revenue of the trading banks is derived from inland exchange.

(c) The present basis of charge for keeping a customer's account is arbitrary since it does not take account of the work involved.

608. We recommend that consideration be given to:

(a) Abolishing or reducing the inland exchange charge made for the collection of cheques.

(b) The fixing of the half-yearly charges for keeping customers' accounts in a manner more commensurate with the work involved.

IV. Finance for Dairy Products Marketing Commission, Apple and Pear Marketing Board, and Other Statutory Marketing Organisations

609. Several marketing organisations whose operations are controlled by statute conduct their banking operations through the Reserve Bank. The organisations marketing dairy products, apples and pears, honey, and milk have a statutory obligation to do so. Those marketing eggs and citrus fruits may use either the Reserve Bank or the Bank of New Zealand; but, naturally, they choose the Reserve Bank because the rate

of interest charged by that institution on advances to marketing organisations is at present only 1 per cent, as against the minimum rate of 4 per cent charged by the trading banks. All of these marketing organisations have a State guarantee for any overdraft accommodation which they may require to carry out their functions.

610. On the evidence before us we consider that the account of the Dairy Products Marketing Commission, by virtue of its size, should remain at the Reserve Bank. It is difficult to see how any one trading bank, in current circumstances, could take over the financing of the marketing of dairy produce.

611. In general, however, we think it undesirable that the Reserve Bank should finance commercial transactions of this kind and would recommend that steps be taken to transfer the accounts of the other marketing authorities to the trading banks.

612. In the view of the Commission, there is no reason why statutory marketing organisations, merely by virtue of the fact that their accounts are held at the Reserve Bank, should receive preferential treatment over other marketing organisations with respect to interest charges. **We therefore recommend that the rate of interest payable on an advance granted by the Reserve Bank to a statutory body should be similar to that which it would be required to pay if its finance were obtained from the trading banks.**

V. Interest-rate Policy

613. Considerable evidence was submitted to the Commission on the efficacy of a rise in interest rates as a means of restraining inflationary pressures. There were substantial differences of opinion or emphasis among witnesses, and it was evident that recognised authorities could be found to support any of a wide diversity of views on this question. There was no suggestion that interest rates should not be permitted to fall during a period of recession. We therefore concentrate our attention on the former question.

614. Flexible interest rates have been used in recent years as one instrument of monetary policy in the United States of America, the United Kingdom, and a number of European countries. But their real value is difficult to discover, because many other parallel or conflicting factors were operating on the economic systems of these countries at the times when interest rates were changed.

615. It was generally accepted by witnesses that higher interest rates would make a valuable contribution to curbing inflationary pressure if they led to a significant increase in savings, or to a significant decrease in expenditure. However, views differed as to whether such consequences would necessarily follow.

Interest Rates and Savings

616. The Treasury pointed out that:

(a) A major part of personal savings was contractual (e.g., life-insurance premiums, mortgage repayments, and so on), and that changes in interest rates would have little effect on such savings.

(b) Many people saved for a specific purpose, such as buying a motor car or section, rather than for the purpose of earning interest.
(c) In part, personal savings were residual and were simply the difference between people's income and what they spent.
(d) Generally speaking, a very large increase in interest rates would be necessary to induce people to save more than usual solely in order to add to their future income.

617. The Treasury considered it debatable whether changes in interest rates would lead to an increase in savings by businesses. On the one hand, since a rise in interest rates would lead to a drop in share values, firms would be inclined to maintain dividend payments to prevent a further drop. On the other hand, since borrowing would be more costly, firms might wish to retain in the business a larger proportion of their profits than before.

618. Finally, the Treasury considered if a rise in interest rates induced people to lend money which they had previously held idle, inflation would be aggravated by the extra spending thus made possible.

619. The Reserve Bank accepted most of the above arguments, but drew attention to three other points which it suggested should not be overlooked:

(a) Relatively low interest rates tend to channel available savings into investment in property or shares. (The consequent increased demand tends to drive up prices in these fields and indirectly aggravates inflationary pressure elsewhere.) Higher interest rates should tend to deflate some of the false property values so common during inflation.
(b) A rise in interest rates may have a sobering effect on private expenditure – especially the tendency to "buy now before prices rise" – if it is taken as evidence of official determination to control prices more effectively.
(c) If interest rates rise, assets such as Government securities could be realised before maturity only by incurring a capital loss. Moreover, with small savings, a greater loss of interest income than before would be incurred if the savings were spent. These factors might lead to greater reluctance by the community to realise assets or draw on past savings to increase current spending.

Interest Rates and Private Expenditure

620. The Treasury pointed out that interest costs were only a small proportion of total costs of firms which were able to turn over their stocks of goods quickly. Taking into account the fact that interest payments on overdrafts are deductible for income-tax purposes, a very large increase in interest rates would be necessary before the extra cost became a significant factor in financing stocks or other working capital requirements. In addition, trends in prices and expected profits were likely to be more important than interest rates in influencing plans for expenditure on machinery and equipment, other than that with a long earning life.

621. Higher interest rates would, however, in view of the Treasury, be a greater deterrent in the case of long-term business investment, and *"would be effective in curtailing expenditure on private housing"*,

through an increase in annual loan repayments on mortgages. Still, loan money released by a fall of spending in these fields might merely be diverted to less essential shorter-term projects, with little reduction in overall spending. A reduction in private house building would also almost certainly lead to demand for the building of more State-rental houses for people who could no longer afford to buy or build their own houses.

622. The Reserve Bank acknowledged the force of many of the above arguments, but pointed out that high interests rates were likely to have a marginal effect in discouraging businesses from holding more than reasonably adequate stocks, especially if the rise in rates helped to induce an expectation of more stable business conditions. It might also encourage business men generally to adopt a more conservative viewpoint and to revise their plans for capital expenditure. Control of bank advances would also be more effective if restraint on the banks' lending through the reserve ratio system were accompanied by restraint on the borrower through higher overdraft interest rates. For a housing mortgage of given amount and term, the higher the interest rate the bigger the instalments, as shown in the following table and comment supplied by the Reserve Bank:

Table Mortgages for Housing at Different Interest Rates and Terms: Quarterly Instalments Per £100

Term	Interest Rate: 4½ Per Cent	5 Per Cent	5½ Per Cent	6 Per Cent
	£ s. d.	£ s. d.	£ s. d.	£ s. d.
Twenty years	1 18 0½	1 19 8¼	2 1 4½	2 3 1¼
Twenty-five years ..	1 13 5	1 15 1¾	1 16 11	1 18 9
Thirty years	1 10 5½	1 12 3¼	1 14 1½	1 16 0½
Thirty-five years	1 8 5¼	1 10 4	1 12 3¼	1 14 3¼

Term	Difference Between Rates Per £100 of Mortgages: 4½ to 5 Per Cent	5 to 5½ Per Cent	5½ to 6 Per Cent
	s. d.	s. d.	s. d.
Twenty years	1 7¾	1 8¼	1 8¾
Twenty-five years ..	1 8¾	1 9¼	1 10
Thirty years	1 9¾	1 10	1 11
Thirty-five years	1 10¾	1 11¼	2 0

623. A person having a table mortgage of £2,500 for twenty-five years at 5 per cent would pay a quarterly instalment of £43 18s. 9d., while a person with a similar mortgage, but at a rate of interest of 5½ per cent, would have to pay £46 3s. 1d. At a rate of 6 per cent the quarterly instalment would amount to £48 8s. 7d.

624. The difference between 5 and 6 per cent on a twenty-five year table mortgage on £2,500 would thus be about £18 a year or 7s. a week. However, the Reserve Bank claimed that "*this would be much more than fully offset by the benefits of a fully effective anti-inflationary*

policy – especially in so far as such a policy would safeguard the purchasing power both of savings and of current incomes. Furthermore, higher interest rates could well result in a reduction in house-building costs".

625. On this point, the Managing Director of the State Advances Corporation expressed the opinion that an easing in the rate of building construction appeared to be desirable in order to relieve the heavy pressures being exerted on resources of labour and materials in the building industry.

Interest Rates and Government or Local Body Expenditures

626. Since Government capital works were already heavily pruned down to those essential to economic development, the Treasury considered that higher interest rates would not lead to any curtailment of spending on such works. The Treasury also made the important point that while the additional cost of Government borrowing is relevant, it is not a very important factor in New Zealand in deciding whether interest rates should be controlled or not. Some interest is paid on departmental investments and is retained within the public accounts, and some is returned in the form of additional profits from State trading organisations. Receipts from taxation on the incomes or profits of those to whom interest is paid, offset some of the cost to the State of the extra interest. If the rate of interest on Government borrowing rose by, say, 1 per cent, the net additional cost of new borrowing and conversions each year would be no more than a few hundred thousand pounds. It would be about fifteen years before all existing debt was converted to debt at a higher rate of interest.

627. The Treasury considered that nearly all local body expenditure was essential to cope with the needs of our rapidly growing population. To postpone some expenditure would therefore merely create a problem for the future, and higher interest rates would increase the burden to be carried by ratepayers in the future.

628. The Reserve Bank considered that higher interest rates would contribute to achieving lower costs generally and would in this way reduce the cost of Government and local body works. Essential works would not be impeded, but to the extent that higher rates induced the paring down of works that could reasonably be dispensed with, slowed down, or postponed, the result would be beneficial. An important factor was that many essential projects were being held up now, not from lack of finance, but from lack of labour and materials.

Interest Rates, Prices, and Wages

629. It was argued by the Treasury and by the President of the Federation of Labour that, in the present state of over-full employment and excessive demand, the cost of any rise in interest rates was likely to be passed on in higher wholesale and retail prices and in the price of services. Further, because of the close link between prices and wages, any rise in prices might well lead to a successful application to the Court of Arbitration for a general increase in wages. In conditions of over-full employment, therefore, a rise in interest rates might well tend to push up prices rather than reduce them.

630. The Reserve Bank did not agree that this would necessarily follow and felt that any such tendency would be more than offset by the reductions of prices which would result from a successful anti-inflationary policy, to which higher interest rates could make an important contribution.

Interest Rates and the Balance of Payments

631. The Reserve Bank pointed out that, if higher interest rates contributed to a reduction of spending, imports would also be reduced, thus assisting in correcting the current balance of payments deficit. In addition, higher interest rates would discourage people overseas from borrowing in New Zealand rather than in their own countries – a tendency which the Reserve Bank was satisfied existed to a significant extent, particularly in the field of meat and wool financing, due to lower rates of interest in New Zealand than prevailed overseas. Low interest rates also deterred the inflow of capital from overseas.

632. The Treasury agreed that it was undesirable for interest rates in New Zealand to become too far out of line with interest rates in other countries.

Interest Rates and Bank Profits

633. Some witnesses objected that higher interest rates would merely add to the profits of the banks and other financial institutions.

634. The Reserve Bank pointed out that, with the banks, certain other factors must be considered:

(i) The fact that overdraft rates have been unchanged for 14 years at what is probably the lowest level they have ever been, and that they were reduced to that level at the Government's request as part of a war-time cheap money policy;

(ii) To the extent that overdrafts are brought down, the total interest received by the Banks will not increase in proportion to the higher rate. (This point was mentioned in evidence by the Chairman of the Associated Banks);

(iii) If higher overdraft rates were charged, higher rates would be paid on fixed deposits;

(iv) The banks will this year be paying out significant sums in the form of interest on borrowing from the Reserve Bank and Treasury;

(v) About 70 per cent of any increase in bank profits returns to the Government as income tax or Bank of New Zealand profits.

To a very large extent, therefore, if not entirely, any increased income received by banks in the form of interest will be offset by other factors.

Interest Rates or Direct Controls?

635. In countering the criticism that flexible interest rates did not provide an effective method of selecting the projects which were essential, the Reserve Bank made the following points, among others:

(i) If two lists were made out, one based on the "essentiality" of all private capital expenditure, the other based on profitability; and if, say, 10 per cent of items (by value) were to be cut off the bottom of each list, the deleted items would not be greatly different nor would the welfare of the economy be necessarily injured more by one set of deletions than by the other.

(ii) Someone must decide the order of "essentiality" of all capital projects and have a logical basis for decisions.

(iii) A completely planned capital programme would be difficult to administer efficiently.

(iv) Such complete direct controls would be unacceptable to many people.

(v) Many "essential" projects are being held up now, not from lack of capital but from lack of labour and materials. Any measure which weeds out marginal demand for labour and materials will facilitate, not hinder, the progress of essential jobs.

The Importance of Marginal Effects

636. The Reserve Bank suggested that, although spectacular results in increasing savings or reducing expenditure could not be expected from moderately higher interest rates, this did not diminish their value as one aspect of anti-inflationary policy. It claimed that at existing interest rates there are, and must be, marginal borrowers and lenders, and any change in interest rates, even if small, would shift the margins to include or exclude persons at or near the margin. In the opinion of the Reserve Bank, since the degree of inflation in New Zealand was not intense, the desired results could be achieved by restricting only a relatively small proportion of total projected capital expenditure or bank overdrafts.

Commission's Conclusions on Interest-rate Policy

637. Believing it to be an important matter, we have given careful consideration to the general question of interest rates. We have come to the conclusion that the past policy of cheap money is unfitted to the conditions obtaining in New Zealand today. Such a policy of arbitrarily fixing a pattern of low interest rates was appropriate during recovery from the depression. However, we have had in New Zealand a period of prosperity with considerable inflationary pressure.

638. In our opinion a continuing policy of fixed low interest rates contributes to inflationary pressure. Under today's conditions such a policy tends both to discourage savings and to increase spending by facilitating borrowing.

639. We were impressed by the opinion expressed by the Managing Director of the State Advances Corporation that an easing in the rate of building construction appeared to be desirable in order to relieve the heavy pressures which are being exerted on resources of labour and materials in this field. In order that the relationship between expenditure on dwellings and on other buildings may be appreciated the figures of the value of building permits issued for the years ended 31 March 1950 to 1955 are shown hereunder:

Year	Dwellings	Other Buildings	Total
	£	£	£
1950	28,999,000	13,478,000	42,477,000
1951	32,728,000	16,042,000	48,770,000
1952	36,457,000	22,786,000	59,243,000
1953	37,278,000	23,850,000	61,128,000
1954	41,736,000	27,764,000	69,500,000
1955	52,767,000	40,638,000 (1)	93,405,000 (1)

(1) Includes Tasman Paper and Pulp Company, £4,050,000.

640. The above figures, and other evidence before us, reveal that the volume of housing construction in recent years has been an important inflationary factor. We believe that the provision of finance for housing in increasing amounts and at low rates of interest, by creating excessive demand for labour and materials, has had the effect of driving up building costs and thus of frustrating, to some extent, the intention of the Government to make available an adequate supply of houses at reasonable cost. The statistics of the number of persons per dwelling show an

occupancy in New Zealand of 3·61 persons, in Australia 3·76, and Canada 4. **In our opinion, an easing in the annual expenditure on building construction including dwellings is desirable, both from a short-term point of view and in the interest of the long-term stability of the building industry. We believe that a rise in interest rates would operate as a restraint on the present rate of building construction and that it should be used for this purpose.**

641. A rise in overdraft interest rates would, in our view, contribute to the more effective control of bank credit. However, it is important that the rise in overdraft rates should be regarded purely as part of a co-ordinated programme to reduce bank credit and that, as suggested earlier, the banks should be given appropriate financial encouragement, by varying the penalties under the reserve ratio system, to co-operate with the credit policy of the authorities.

642. In inflationary circumstances it is a mistake for the Government to endeavour to hold down rates of interest by refraining from borrowing to finance its own capital expenditure and meeting its requirements by drawing on accumulated cash balances or by increasing its borrowing from the banking system. Either course is directly inflationary.

643. It has been suggested that the effect of higher interest rates on both saving and borrowing would be only marginal. Even if that is so, marginal effects are important in their effect on economic equilibrium. The joint effect of the two marginal influences we have referred to should help to restore economic equilibrium gradually and without disruption.

644. In our view the ultimate objective should be the complete freeing of interest rates from control so that supply and demand will bring about periodic variations best suited to the conditions from time to time obtaining. We realise, however, that a sudden complete removal of long-standing controls may have serious repercussions while inflationary circumstances persist. In the meantime, therefore, we recommend that progress be made towards the above ultimate objective by forthwith increasing in some degree the whole pattern of interest rates.

[Some steps in this direction have been taken by the Government since this report was written, e.g., by raising the average level of interest rates which the banks are permitted to charge on overdrafts, and by increasing the return offered on the current conversion loan, while at the same time raising the rates which local bodies may offer for loans.]

645. Unless the foregoing policy is adopted and carried out fearlessly, we consider that other remedies will be much less effective. This question of interest rates is a striking example of the imperative necessity for co-ordination of various phases of Government policy.

VI. Control of Borrowing by the Public

A. CAPITAL ISSUES COMMITTEE

646. The evidence before the Commission revealed a strong opinion on the part of some witnesses that the Capital Issues Committee, in the exercise of the discretionary powers entrusted to it, had shown a strong bias towards assisting Government issues of capital at the expense of the

private sector, and that its decisions were influenced by the policy of the Treasury. The constitution of the Committee, comprising as it does a majority of State servants, seems to have contributed to the attitude of some of these witnesses.

647. **So long as it is necessary to retain the Capital Issues Committee, we consider that its decisions would be more widely acceptable if the personnel were changed by reducing the number of State servants on the Committee and correspondingly increasing the number of members selected or appointed from the business community.**

648. From the details supplied to us of the applications declined and deferred, it appears that the Committee has performed a useful task in helping to restrain the amount of investment in the private sector of the economy at a time when the available physical resources have been subjected to heavy pressure.

649. **We make the following recommendations in regard to matters which at present come within the purview of this Committee:**

(a) That the limit of issues of capital which may be made without the consent of the Committee (now fixed at £10,000) should be raised appreciably. The present restrictions encourage complicated procedures in order to avoid the need for making application to the Committee.

(b) That the issue of preference shares should be freed from control, with the exception of:

(i) Redeemable preference shares; or

(ii) Cases where the preference dividend is non-cumulative.

(c) That the fixing of the appropriate premium on an issue of shares should be left to the discretion of the directors of the company concerned.

(d) That the Committee should not refuse permission to companies to issue capital on the grounds that the proceeds of the issue are to be used to reduce or repay bank overdrafts. Such a policy tends to increase the difficulties of controlling bank credit. It should be a condition of any consents granted under this recommendation that the proceeds of any such issues should be applied to the reduction or extinction of any bank accommodation previously granted.

B. HIRE-PURCHASE

650. The degree of inflationary pressure which can be attributed to hire-purchase trading depends on its relationship to the overall trading position at any given time.

651. Giving evidence before the Commission, Mr Ashwin said:

> . . . it (hire-purchase) has not been a significant factor in the country so far . . . what you have to watch . . . is violent changes in the level of it. After all, if your economy has adjusted itself to a given level of hire-purchase, the money coming in will balance the higher spending . . . at times of prosperity or a bit of a boom starts, it is apt to swing up and accentuate.

Mr Fussell on the same subject said:

> That (hire-purchase) is not a central banking matter at all, our matter is concerned with finance, and we would not be experts in determining what is best to do about that, and it would have to be decided on the degree of hire-purchase income in relation to national turnover or national income, and also the relativity of it in New Zealand and whether or not it has an inflationary effect. On that

point as to whether it is an inflationary factor, I should say two things – one, that it is an inflationary factor to the extent that it enables people to spend next year's income, or even the year after next's income, now. But, on the other hand, . . . in certain respects where it is for industrial purposes that factor may be offset by the impetus given to production, . . . I would be the last to suggest that because it has some inflationary factors, hire-purchase should be abandoned, because it is the family man's mode, and particularly the family man on a small income, and the young married people's mode of getting access to needful things which they would not be able to finance entirely out of current income. But that is my general view.

Question:

. . . I suggest that people, workers, who have entered into hire-purchase agreements have a powerful incentive to increase their earnings because people will work harder to meet an obligation than to save . . . ?

Mr Fussell:

. . . I agree . . .

652. In New Zealand there are no satisfactory statistics available on any section of hire-purchase trading, and it is therefore impossible for the Commission to make any statement on the question as to whether hire-purchase trading is actually increasing in total or not. (In our recommendations regarding improved statistical information we recommend that statistics of hire-purchase trading be collected.)

653. Another factor which must be taken into consideration in weighing the inflationary effect of hire-purchase is that part of the fall in small savings mentioned elsewhere in this report has been replaced, or probably more than replaced, by mortgage payments and repayments under hire-purchase agreements.

654. In other words, instead of "saving to spend", people have undertaken contractual obligations, which means that the saving comes after the spending. On this point also we suggest elsewhere in this report that more statistics are required.

VII. The Stimulation of Private Savings

655. In Section Five of this report there is a full discussion of the importance of business and private savings to the national economy. Here we discuss only the various methods by which private saving might be stimulated.

656. Except for some Social Credit witnesses, including Miss M. H. M. King (one of the witnesses for the New Zealand Social Credit Association), there was general agreement among those who appeared before the Commission that saving should be encouraged in every possible way.

657. It is obvious that when, as in recent years, our economy is stretched to the limit, unnecessary expenditure of all kinds should be restrained. Saving is a form of self-restraint. A proper public understanding of this, and of the useful purpose it serves (as explained in Section Five), is necessary to the encouragement of saving.

658. The widespread agreement of a number of witnesses with the views expressed in Section Five is evidenced by the following extracts from the record of proceedings of the Commission:

Mr Kelliher:

The decision as to how much of current production is to be consumed and how much is to be put aside as "seed corn" to provide for future needs is determined mainly by the spending habits of the people as a whole . . .

Mr Ashwin:

If you could persuade the people to drop the level of consumption by saving more, you could right . . . (the present undue pressure on the economy) that way . . .

Mr Ashwin:

. . . in the long term interest of the community I would think the difficulty (of inflationary pressure) would be better overcome by greater saving rather than lesser (public or local body) works, because works are needed to maintain the standard of living in future years . . .

Mr Fussell:

For a country like New Zealand, the only sort of savings that this free-minded democracy can tolerate are those which are voluntary.

(However, Mr Kelliher stated that "*. . . if it is assumed that the level of current savings required to finance current investment is inadequate . . . some scheme for compulsory saving could be instituted here*".)

Mr Sutherland (General Manager of the Auckland Savings Bank), quoting the President of the German League of Savings Banks:

Savings are the road to material freedom as long as we remain on guard against the social crime of secret or open inflation.

Interest Rates on Deposits

659. Some witnesses considered that an increase in interest rates on fixed and demand deposits would help to raise the level of savings, but opinions varied widely as to how great an increase would be required.

660. Mr Sutherland stated in his submissions that:

I would agree that a rise of only ¼ per cent would not bring spectacular results, but I do contend that it would guarantee that extra incentive which would produce the steady growth in savings that should take place and has taken place in normal times, and when freedom of action (to raise interest rates) was permissible or when a realistic attitude was adopted in regard to interest rates.

661. Other witnesses, however, were less confident. They did not believe that even a 2 per cent rise in interest rates would necessarily bring about an increase in "small" savings. Mr Kelliher in his submissions suggested that saving should be encouraged "*. . . by allowing a generous return on small savings*". Mr Ashwin on the other hand said "*I think the average man in the street saves his money to buy something*" (i.e., not to get interest).

Note—In the United Kingdom if a depositor has £50 in an ordinary savings account, he can open a special investment account on which he is paid 3 per cent instead of 2½ per cent. According to Mr Sutherland this has brought about large increases in amounts lodged.

662. However, in discussing the probable effects of a rise in interest rates, at least two important factors must be taken into account. First, a rise in interest rates could cause a fall in the capital value of some assets (e.g., existing Government or local body stock). Secondly, the psychological effect of any changes has some importance.

663. We would recommend that the trustee savings bank and Post Office rates should be increased as part of the general policy on interest rates set out earlier in this report.

Income-tax Rebate

664. An income-tax rebate on savings on the following lines was suggested:

(a) Deduction of savings-bank interest, with a fixed maximum, from returnable income. This would operate in the same way as the present allowance for life-insurance premiums, the maximum for which is £175. According to the Associated Savings Banks' submission:

> Germany and Finland have gone further by granting exemptions from income tax on savings from income deposited with the savings banks for at least six months.

(b) Deduction from returnable income of the amount of actual savings deposited with a savings bank during the income year.

665. The Commission would recommend that the first of the above proposals should be given consideration by the Government.

Maintenance of Purchasing Power

666. Mr Walsh, appearing for the Federation of Labour, suggested to the Commission that the Government should, in the present inflationary situation, take action to preserve the purchasing power of savings in general, and of small savings in particular. He submitted that, with this object, *"a beginning be made in respect to Post Office and national savings . . . so that after three years, when withdrawing his deposit, the depositor receives, besides the interest already paid, the same purchasing power as he originally invested"*. The Commission was informed that a system of this nature is in operation in Iceland with respect to private savings.

667. The Commission cannot recommend the adoption of such a system for the following reasons:

(a) It would cover too narrow a field of investment.

(b) The cost would have to be met from taxation levied on the whole community for the benefit of this special section.

(c) Depositors would no longer have strong reason to oppose inflationary action by a Government.

(d) It would be a tacit admission by a Government that inflation was inevitable and could not be halted.

(e) If deflation should occur, depositors would not be satisfied to receive back less than they had paid in.

Premiums on Savings

668. The Associated Savings Banks in their submission gave the following details of a Swedish premium scheme approved by the Riksdag in May 1955:

> Sums up to a maximum of Kr. 1,000 (£70 approximately) each year which are deposited during 1955 and 1956 on a specially opened savings account, and which remain on that account until the end of 1960, will entitle the holder to receive a savings premium of 20% for 1955 savings, and 15% for 1956 savings, reckoned in each case on the amount saved, subject to the proviso that during the year the saver must have increased his total bank balances by not less than the sum deposited on savings account. The premium is free of tax.

669. According to *Index*, the monthly economic review published by the Svenska Handelsbanken, judged by first results this scheme has proved popular:

By the end of August about 120,000 premium savings accounts had been opened in the savings banks alone. If the commercial banks and the Post Office Savings Bank are included, the number of new accounts now exceeds 190,000.

670. The Commission would recommend a scheme of this nature for consideration by the Government.

Lottery Scheme

671. Another scheme adopted per medium of the savings banks in Germany was mentioned by Mr Sutherland. There, lotteries are run with Government approval. For every deposit of 9 deutschmarks or multiple thereof, 8 are credited to a savings account and the remaining one is paid over to a lottery pool and, after deducting expenses, lottery prizes are regularly drawn. This method, combined with the tax exemption mentioned in paragraph 664 (a), has helped to produce substantial increases in savings.

672. The Commission makes no comment on this scheme.

Trustee Savings Banks

673. From evidence presented to the Commission, it would appear that the trustee savings banks in New Zealand are very severely restricted in their activities by the Trustee Savings Bank Act 1948, which repealed the Savings Bank Act 1908 and its amendments.

674. For example, section 5 of the 1948 Act states:

1. The Head Office of each savings bank shall be situated in the city or borough indicated in the following table:

Savings Bank	Head Office
Auckland Savings Bank	Auckland.
Dunedin Savings Bank	Dunedin.
Hokitika Savings Bank	Hokitika.
Invercargill Savings Bank	Invercargill.
New Plymouth Savings Bank	New Plymouth.

2. Every savings bank may continue to have such branch offices and agencies as it has at the commencement of this Act.

3. After the commencement of this Act, no savings bank shall establish any new branch office or agency situated more than twenty-five miles from the head office of the bank.

675. The Commission agrees with this statement made in the Associated Savings Banks' submission:

. . . there cannot be too many opportunities granted to the people to save voluntarily . . .

676. There does not appear to be any valid reason why the opportunity for depositors to exercise a choice as to where they will deposit their savings, should exist in only five limited areas in New Zealand. In all other places the Post Office Savings Bank is the only savings bank available.

677. In the areas where they operate, trustee savings banks in general appear to pursue a much more aggressive policy than the Post Office in encouraging or stimulating saving by extensive use of advertising, by essay competitions among school children, and by featuring special events such as World Thrift Day (31 October each year). A noteworthy activity of the Auckland Savings Bank has been the establishment of thrift clubs of which there are 511 in operation, with accumulated savings totalling £470,000.

678. According to the evidence presented by the Associated Savings Banks, section 30 of the Trustee Savings Bank Act. *"Repayments of deposits guaranteed"* (by the Consolidated Fund) *"is given as a very definite reason why no new savings bank would receive governmental consent to be established"*.

679. In the opinion of the Commission this is not a sufficient reason for preventing the establishment of new trustee savings banks in New Zealand.

680. We therefore recommend that the restrictive provisions in section 5 be removed from the Trustee Savings Bank Act 1948 and that every possible encouragement be given to the establishment of new trustee savings banks in the main centres and to the opening of branches in the smaller towns.

681. In our opinion the factor of local pride is important in the success of trustee savings banks; a substantial proportion of their funds, too, is normally made available for local investment.

682. We would draw attention to the fact that in Great Britain recent legislation provides for the establishment of savings banks in new and growing centres of population and that an attempt is being made to provide gradually a complete coverage of the country similar to that provided by the Post Office Savings Bank branches.

683. In the early years of new savings banks the Government might consider granting exemption from income tax on moneys put to reserve.

Savings Banks Operated by Trading Banks

684. In January 1955 the Australian Government granted permission to two Australian banks to carry on savings-bank business.

685. The main conditions under which they will operate are as follows:

(1) Apart from cash or moneys on deposit with other banks, the new savings banks may invest depositors' funds only in:

(a) Commonwealth and State Government securities.

(b) Securities of an authority constituted by or under Commonwealth or State Act of Parliament.

(c) Loans to building societies, the repayment of which is guaranteed by the Commonwealth or a State; and

(d) Loans for housing or other purposes on the security of land.

(2) The new savings banks must at all times hold at least 70 per cent of depositors' funds in cash, plus money on deposit with the central bank, plus securities of types (a) and (b) in (1) above.

(3) The new savings banks must at all times hold at least 10 per cent of depositors' funds in Commonwealth Treasury bills, plus money on deposit with the central bank.

(4) The banks may not accept deposits from a trading or profit-making company or body.

(5) The bank may not allow an account other than the account of a local authority, friendly society, co-operative society, or any other society, body, or club to be operated on by cheque.

686. Firmly believing that there cannot be too many opportunities for saving, the Commission would recommend that the Government should fully investigate the Australian proposals and the operations of these savings banks.

Wider Opportunity for the Small Investor

687. The Commission noted with interest the statement in the submission of the Stock Exchange Association that the *"mainstay of the average sharebrokers' business is a substantial number of small orders"*.

688. The nature of this business was indicated by the experience of one stockbroker's office in which fifty buying orders averaged £245 10s., the largest being £1,047 and the smallest £19 15s. 11d. Similar figures from another office showed the largest transaction as £1,006 and the smallest as £13 19s. 9d. In both instances a substantial number of orders was received from women.

689. The wide spread of investment is shown by the fact that 178 clients who provided orders for £300 or under followed fifty-two different occupations. The orders came from a comparatively small number of professional men and from a substantial number of married women, from students, clerks, typists, school teachers, and so on.

690. These statistics seem to the Commission to show that there is opportunity for the encouragement of investment among sections of the community which, in the past, did not usually invest savings in stocks, shares, Government loans, or local body debentures.

691. From this point of view the Commission commends the efforts made by the stock exchanges to have shares which stand at a high figure subdivided into smaller units which will bring them more easily within the reach of the smaller investor. The Commission would also draw the attention of local bodies to the advantage of issuing inscribed stock and in this way making their securities more acceptable to the small investor.

692. The Commission considers that the stock exchanges can play a considerable part in encouraging savings, and that it would be in the national interest if more facilities could be made increasingly available to the small investor, and if attention were drawn by proper means to the opportunities which now present themselves to him.

VIII. Need for New Financial Institutions

A. POSTAL CLEARING SERVICE

693. Mr D. J. Janus presented to the Commission a detailed description of the Netherlands "Postal Clearing Service". He explained also that similar systems were used in Belgium, France, Western Germany, Switzerland, Italy, and Austria. The purpose of the Netherlands system is to enable business firms and private individuals who have accounts with the Clearing Service to transfer money to each other's accounts by filling in a simple form. According to Mr Janus, the system works very efficiently, is cheap and simple, and does away with the costly and cumbersome method of money transfer as used in New Zealand.

694. The system is operated by the Post Office as an adjunct to the Post Office Savings Bank. As described to the Commission by Mr Janus, the Postal Clearing Service works in this way:

(a) Private individuals and firms desiring to make use of the service establish special credit accounts at the Post Office.

(b) When it is desired to make a payment to another holder of such an account a slip is made out in triplicate. Two copies are posted to the Clearing Service and one is retained by the payer. No postage is charged.

(c) The Clearing Service debits the account of the payer, credits the account of the payee, and sends both parties a statement of what has been done. This statement is accepted as a receipt for payment.

695. The chief advantages of a Postal Clearing Service over the cheque system as commonly operated in New Zealand appear to be that:

(a) No stamp duty is payable.
(b) No internal exchange is charged.
(c) A large number of payments can be made by the filling in of a single schedule.
(d) The risk of forgery is reduced to a minimum.
(e) The book work for bank and client is reduced to a minimum.
(f) Clearance is accelerated.
(g) Salaries, pensions, etc., are paid in this way not only by business firms, but also by Government, local bodies, schools, etc.
(h) The interest earned by the Clearing Service by lending money to the Government meets all charges.

696. This scheme seems to possess some attractive features. The Commission would recommend that the full details of its operation should be investigated by the appropriate departmental officers.

B. SHORT-TERM MONEY MARKET

697. One of the recommendations made by the Reserve Bank for the improvement of the present monetary system was that a short-term money market be established in New Zealand. The Reserve Bank considered that there was a hiatus in the present system, and that such a market would enable people with funds who were not seeking long-term investments, to invest the money for a short period. These funds would then be available to the Government and financial institutions for short-term loans. The Reserve Bank also considered that the short-term money market would assist the control of credit and would have a general stabilising influence.

698. The general arrangement recommended was that three-month (and possibly six-month) Treasury bills should be made available through the trading banks for public purchase. The minimum size bill would be either £1,000 or £5,000. They would be transferable by delivery, and there would be a right to discount the bills with the Reserve Bank at any time without penalty. The rate of interest suggested was 1½ per cent per annum. It was not intended that the trading banks should participate and, in the first stages of development of the market, there would be no tendering for the bills, as is normal practice in the United Kingdom. In that country, Treasury bills are issued by tender every week and there exists a highly organised system of discount houses whose business is almost entirely the handling of those bills.

699. The Governor of the Reserve Bank advised the Commission that the Government had approved of the short-term money market in principle. He explained, however, that no action had been taken to bring such a market into existence since the effect on the trading-banks' cash position might be serious under the existing reserve ratio requirements. Nevertheless, the Governor considered that a time like the present, when liquidity preference was high, would be a desirable moment to establish such a market.

700. The Secretary to the Treasury supported the establishment of a short-term money market on the grounds that it would provide a desirable facility; that it would give more control over idle money; and that, through changes in the rate of interest, it could prove an effective immediate weapon in monetary control. He did not think that the $1\frac{1}{2}$ per cent per annum rate of interest proposed would affect the general level of interest rates.

701. The proposal was supported in general outline by the Associated Banks. They pointed out that fixed deposits had declined relative to the money supply since pre-war days. The Associated Banks, however, considered: (a) that the trading banks should be allowed to participate in the short-term market; (b) that the Reserve Bank should apply a rediscount rate to discourage indiscriminate buying and selling of the bills; and (c) that the adoption of a rate of interest higher than that now paid by the trading banks for short-term fixed deposits would merely result in a transfer from the fixed deposits, unless the trading banks were permitted to offer a competitive rate. Trading-bank participation in the short-term market would be conditional upon a reorganisation of the reserve ratio system on the special lines suggested by the trading banks. This latter point is referred to in another section of this report where the reserve ratio system is fully discussed.

702. The Reserve Bank proposals were commented upon in a number of other submissions made to the Commission. There was no objection to the proposals in general outline, particularly as it was clear that the short-term money market would be implemented in a small way at first. The main lines of criticism were that the rate of interest offered might not be attractive enough to encourage investment; and that the proposal, even at the last stage envisaged, did not go far enough, in that the Government would be the only borrower and the funds would not be available to local bodies or for industrial finance.

703. The Commission's view is that a short-term money market should be established in New Zealand. We consider that:

- **(a) The minimum size Treasury bill should be £1,000 and that both three- and six-month bills should be offered at appropriate rates of interest.**
- **(b) The trading banks should be allowed limited participation in this market.** (See Part I of this section of the report dealing with the reserve ratio control system.)

704. We believe that a short-term money market on the above lines would assist to some degree with Government finance in that it would enable part of the Government's short-term financial requirements to be met from the existing supply of money rather than by additional borrowing from the banking system. It would also be of assistance to the trading banks and the business community. We do not think that such a market would immediately develop to any great extent in New Zealand. However, in view of the useful purposes which this market would achieve if it received sufficient support, we feel that the experiment of introducing it would be well worth while.

C. INDUSTRIAL FINANCE

705. One of the methods of improving the present monetary and financial system suggested by the Reserve Bank was the establishment of an organisation in New Zealand to provide medium- and long-term capital for the smaller industrial and commercial units.

706. In evidence before the Commission, the Reserve Bank gave the following general grounds in support of the proposal:

(a) The working population in New Zealand was likely to rise by somewhere between 400,000 and 500,000 by 1975. The capacity of the primary industries to absorb additional labour was definitely limited, and it would be necessary for the greater proportion of the future increase in working population to be employed in secondary and servicing industries.

(b) Many of the large industries operating in New Zealand today had grown over a relatively short space of time from small family units, their expansion having been financed substantially from profits made through the years and not distributed, and from reliance on bank overdraft accommodation. Of 11,358 private companies in New Zealand at 31 December 1947 (the latest figures available), 9,557 had a nominal capital of £10,000 or less; and of 1,381 public companies in existence at the same date, 486 had a nominal capital of £10,000 or less.

(c) The smaller- and medium-sized businesses generally found it more difficult to raise new capital from outside the business than did the larger units. The risks were greater and the businesses not well known.

(d) A number of other circumstances (e.g., the growth of hire-purchase and credit account sales) had also combined to require increased capital to finance a given turnover.

707. The Reserve Bank stated that it had attempted to assess the validity of these arguments as a background to the proposal for a separate organisation to undertake industrial finance. The bank's inquiries had been made *"from a large and representative group of business interests"* and the bank had gained *"a clear impression . . . that the formation of an organisation to assist industrial and commercial development is warranted"*.

708. The desirability or otherwise of such an organisation was discussed by other witnesses appearing before the Commission, and some reference was also made to it in the written submissions. The evidence of the Associated Banks and the Stock Exchange Association supported the establishment of an organisation of this nature. The only opposition to the Reserve Bank's proposal that a public company be formed for this purpose came from a limited company, The United Dominions Corporation (South Pacific) Ltd., which contended that its own activities were of the nature envisaged.

709. We note that the organisations representing various groups whose members might be expected to be interested in this proposal (e.g., the Manufacturers' Federation and Associated Chambers of Commerce) did not make representations to us on these matters. No evidence was produced to show that any reasonably worth-while and credit-worthy venture had failed in this country in recent years merely because of inability to obtain sufficient capital.

710. Our attention was drawn to the various forms of public institutions or private companies established in other countries in recent years to provide medium- and long-term finance for the smaller industries. Our comment on these developments is that each is designed to meet the particular circumstances of the country in which it is established and that they are not necessarily precedents which should be followed here.

711. One further point made to us was that a number of industrial units placed undue reliance on bank overdraft for what were really long-term capital requirements. We do not doubt that there is some truth in this contention, and elsewhere in this report we have set out recommendations which are designed to meet the situation. We refer particularly to the sections of the report dealing with capital issues control, methods of increasing savings, interest rates, and the control of creation of credit.

712. The present conditions of over-full employment appear to us to call for the fuller use of the capital equipment already in the country. We do not regard the present time as the most appropriate for the systematic promotion of further industrial ventures.

713. As long as conditions remain as they are at present, the capital for any new ventures should be provided from current savings, which it would not be if a large part of the funds came from the Reserve Bank. The creation of new money now for this purpose would have a further inflationary influence.

714. We do not consider that a case for the immediate establishment of an Industrial Finance Corporation has been substantiated, although we agree that such an organisation may prove desirable at some time in the future. The development of the country's financial institutions to meet the changing pattern of industrial activity will need to be watched closely, as it may be necessary to move quickly if lack of opportunity for employment in secondary and servicing industries appears likely at any time to affect the well-being of the community.

D. LOCAL GOVERNMENT CAPITAL FINANCE

715. Difficulties faced by local bodies in raising the money to fill approved loans were brought to the attention of the Commission at an early stage in the public hearings. In paragraphs 197 to 216 of Appendix C we trace the history of local government borrowing in some detail. Briefly, the recent history of local body indebtedness is that in 1934 the indebtedness was £77·5 million and it had fallen to about £73 million at the outbreak of the second world war. The post-war figure of about £66 million again fell steadily to its lowest point of £61·9 million, which was reached in 1951. Over the last few years the increases have been substantial, and by March 1955 the total indebtedness had reached nearly £91 million. The steady decline in indebtedness over the war and post-war years reflects the general postponement of many local body capital works which would otherwise have been started in those years. Over the same period, earlier loans were repaid as they fell due. The effect of this situation, and similar postponements of capital works in the Government and private fields, is discussed in other sections of this report.

716. The loan moneys actually raised by local bodies, and the loans sanctioned by the Local Government Loans Board over the past three years, are shown in the following table:

(£ million)

	Loan Moneys Raised	Loans Sanctioned	
		Works	Redemption
1952–53	11·6	17·9	0·2
1953–54	16·6	24·0	0·3
1954–55	15·4(1)	25·8	0·4

(1) Provisional.

717. The table shows that, despite the increase in loans approved, the amount raised during the last financial year has fallen. The smaller local bodies have found it particularly difficult to raise loan moneys, and special difficulties have also been met in the Auckland urban area.

718. A particular feature of the market for local body loan moneys has been the substantial withdrawal of institutions (Government lending institutions, private insurance companies, trustee savings banks, etc.) from this field of investment in recent years. The increases in interest rates approved for local body loans have not been in line with the increased returns available from other avenues of investment, and the funds handled by these institutions have been going into alternative channels such as company shares and the purchase or erection of buildings for rental purposes. Statistics supplied to the Commission by the Local Government Loans Board give the following as the sources of funds borrowed by local bodies during the year ended 31 March 1955 under some of the loan authorities issued during that year:

	£
Private investors(1)	5,552,320
Insurance and trust companies(2)	1,234,895
National Provident Fund..	747,200
State Advances Corporation	273,040
Other companies	167,200
Other local authority funds(3)	120,000
Other sources	104,950
	£8,199,605

(1) Includes some public issues which do not show the various sources of the moneys and may include some investments by companies, etc.
(2) Includes insurance companies, savings banks, trustee companies, building societies, and trading-bank investments.
(3) Sinking funds, depreciation funds, etc., of other local authorities.

719. The foregoing statistics cover only a little over half the full amount borrowed by local bodies during the year, but they are sufficiently comprehensive to indicate the relative importance of the various sources contributing to local body loans at the present time.

720. There is no doubt that the group problems of local bodies in the raising of money to fill loans could be almost immediately overcome by varying the terms of these loans to make them more attractive, while at the same time retaining present terms in relation to other avenues of investment. However, the Government cannot escape some responsibility

for seeing that all would-be users of capital funds are treated fairly, and that no one section obtains undue advantage. The desirability or otherwise of local body loans from the point of view of the investor is largely one of the rate of interest payable. **It appears to us essential that the maximum local authority borrowing rate should be revised from time to time so as to preserve an appropriate margin above the effective rate at which the Central Government can borrow on the market.** (See also paragraphs 207 to 214 and 353 of Appendix C.)

721. Apart from the question of interest rates, the major suggestions which were put to the Commission were that an organisation – a Local Government Finance Corporation – should be established either to:

(a) Pool local body surplus loan moneys, and make them available to other local bodies who may be having difficulty in raising loans; or

(b) Carry out the pooling arrangements as above, but also raise funds centrally by the issue of corporation debentures.

722. In so far as the pooling arrangements are concerned, the Commission has noted the statement of Government policy announced on Tuesday, 29 November 1955, to the effect that the Investment Committee established to control the National Provident Board's funds would also be authorised to control a pool of local body funds that could be lent to other local bodies. This proposal apparently replaces and extends the previous activities of a private sharebroker who had been of "*considerable assistance*", according to the Secretary to the Treasury, in carrying out a limited function of this nature.

723. The Commission agrees that an organisation handling the pooling of these funds can be of considerable assistance in this field.

724. Whether or not some central organisation should actively raise funds for local body works gives rise to two main questions:

(a) Is this desirable?

(b) If so, would it then be necessary to establish a separate organisation in the form of a Finance Corporation?

725. Although the difficulties facing many local bodies in raising loan moneys were referred to on a number of occasions in evidence before the Commission, the main organisations representing various groups of local authorities did not make any written submissions on the matter, nor did they seek to appear at the public hearings. The Commission could assume from the lack of interest on the part of these organisations that they did not feel that there was any problem to be solved, but the evidence before the Commission was that the smaller local bodies, in particular, were facing serious difficulties of this nature at the present time.

726. **We do not favour the establishment at this stage of a Government-sponsored Local Government Finance Corporation, but we consider that the local bodies themselves should give this question some further consideration.** If they do so, they will need to keep the "local interest" aspect steadily in view. Evidence before the Commission showed that vigorous local publicity has undoubtedly helped to fill many local body loans. Finance Corporation debentures may appeal to investors as a first-class security, but may lack the "local interest" appeal of individual local body issues.

E. RURAL FINANCE

727. The question of establishing a separate rural bank was suggested in the written submissions of individuals who did not appear at the public hearings, but no representations regarding the need for such an institution were made by any farmers' organisation. The Commission is satisfied that, in general, the coverage of the organisations providing financial assistance for primary producers is satisfactory, and that no special rural bank is required at the present time.

728. One witness at the public hearings submitted that the industry reserve funds should be used to provide seasonal finance for primary producers. These are statutory funds and we do not consider that, having regard to the purposes for which they were established, they should be used for short-term finance.

IX. New Note Issue

729. The submission of Federated Farmers of New Zealand (Incorporated) included the following suggestion:

The Reserve Bank should arrange a new note issue to ensure the elimination of the "hot" money in safes and safety deposit boxes and under mattresses.

730. No evidence was given in support of this proposal. Nor was it stated whether the suggested new note issue should include all denominations or only notes for larger amounts of £5 and upwards.

731. Such a measure might possibly be of some value in bringing to light evasion of taxation. On the other hand it might induce people to spend hoarded money and so increase inflationary pressures. In view of the lack of evidence, we draw attention to this suggestion without making any recommendation.

X. Overseas Trade and the Monetary, Banking, and Credit Systems

INTRODUCTION

732. We have already emphasised in this report that the New Zealand economy is still vitally dependent on overseas trade despite the marked expansion which has taken place in our manufacturing and service industries since 1934.

733. Two major problems arise from this dependence on overseas trade. First, it is necessary to ensure that we maintain at all times reserves of overseas exchange adequate to carry us through any adverse unforeseen circumstances with a minimum of disruption. This means that we should not allow persistent deficits to occur in our balance of payments. Secondly, it is desirable to take steps to protect our economy as far as possible against the effects on domestic incomes, prices, and the supply of money, of marked changes in export and import prices. It is with these two problems and the means of meeting them that this section of the report is concerned.

A. THE BALANCE OF PAYMENTS AND OVERSEAS EXCHANGE RESERVES

The Importance of Maintaining Adequate Reserves of Overseas Exchange

734. One of the major objectives of Government is to maintain full employment of labour. In New Zealand, its ability to do this is heavily dependent on the maintenance of an adequate flow of imported goods. Eighty-two per cent of our imports in 1953 were raw materials, fuels and

lubricants, and equipment associated with production. It follows that to sustain production and preserve full employment we must have adequate overseas reserves to draw upon to maintain imports if the exchangeable value of our exports falls. Adequate reserves are also necessary if, in times when our terms of trade are less favourable, we are to maintain a reasonable flow of the fully-processed imported goods which are essential to the maintenance of our standard of living. These reserves must be built up from current income in prosperous times.

735. There is no general rule for determining what is an adequate reserve of foreign exchange at any time. Factors to be taken into account in assessing the adequacy of reserves include:

(a) Government policy at the time (e.g., its ability and willingness to keep inflationary pressure under control, whether or not it is protecting the balance of payments by direct controls, and so on).

(b) The ability and willingness of the Government to borrow overseas.

736. If the Government wishes to preserve a reasonable degree of freedom in external trade, and to avoid undue reliance on overseas borrowing, it seems evident that the exchange reserves of the banking system must be maintained in a period of prosperity at a level equivalent to at least six months' overseas payments. A brief survey of the movement of the reserves since 1935 may be of assistance in assessing their adequacy at the present time.

737. The following table shows the changes which have taken place in the level of the net overseas assets of the banking system and the Reserve Bank's gold reserve between 1935 and 1955 and relates them to overseas payments and import prices in the years concerned:

Exchange Reserves of the Banking System, 1935 to 1955

Calendar Year	Exchange Reserves (1)	Overseas Payments	Percentage of Reserves to Payments	Number of Months' Payments Covered by Reserves	Index of Import Prices (Base: 1936–38 = 100)	Value of Reserves in 1936–38 Purchasing Power
	£(N.Z.) million	£(N.Z.) million				£(N.Z.) million
1935 ..	47	41(2)	116	14	96	49
1939 ..	15	65(2)	23	$2\frac{3}{4}$	102	15
1944 ..	57	98·8	58	7	167	34
1947 ..	110	190·5	58	7	226	49
1949 ..	77	165·2	47	$5\frac{1}{2}$	210	37
1950 ..	85	199·1	43	5	230	37
1951 ..	114	260·1	44	$5\frac{1}{4}$	269	42
1952 ..	84	268·8	31	$3\frac{3}{4}$	293	28
1953 ..	115	240·1	48	$5\frac{3}{4}$	277	41
1954 ..	130	287·9	45	$5\frac{1}{2}$	274	47
1955 ..	100	320·6	31	$3\frac{3}{4}$	(3)	(3)

(1) Approximate average for calendar year calculated from average of net overseas assets of banking system for calendar year and Reserve Bank's holdings of gold (at market value) as at 31 March of year concerned.
(2) Approximate only.
(3) Not available.

738. The overall reserve position of the country is somewhat better than is revealed by the above figures of the holdings of the banking system, in that the Government and private persons hold overseas securities, some of which could be realised in the event of an emergency. The following are figures of Government holdings of overseas securities since 1946:

As at 31st March—	Government Holdings of Overseas Securities(1)	As at 31st March—	Government Holdings of Overseas Securities(1)
1946	8·3	1951	21·2
1947	7·0	1952	27·2
1948	8·5	1953	24·9
1949	7·9	1954	29·4
1950	7·6	1955	31·8

(1) As shown in Public Accounts. Some of these securities are held against specific commitments and contingencies and cannot be regarded as supplementary to "net overseas assets" as reserves.

Source: Reserve Bank of New Zealand.

739. No recent figures of private holdings of overseas securities are available. However, the following figures show private holdings of overseas securities as at 1 November in the years mentioned:

1946	£68·3 million
1948	£56·4 million
1949	£55·9 million

740. It will be noted that the exchange reserves (excluding private and Government security holdings) were equal to about fourteen months' overseas payments in 1935, but by 1939 had fallen to the very low level of £15 million or to an amount equivalent to less than three months' overseas payments in that year.

741. The reserves were built up substantially during the war, and by 1947 were almost £110 million which was equivalent to about 7 months' payments in that year. The marked drop in their value between 1947 and 1949 is partly accounted for by the 20 per cent appreciation of the New Zealand pound in 1948 which, while not reducing the amounts held in sterling, reduced their value in terms of New Zealand currency. Another factor was a substantial repayment of debt domiciled overseas. And finally, the volume of imports increased so that, despite the appreciation, the New Zealand value of goods imported was well sustained. The reserves by 1949 had fallen to the equivalent of 5½ months' payments.

742. The wool boom in 1950–51 was largely responsible for building up the reserves from £77 million in 1949 to £114 million in 1951. However, high domestic incomes, the relaxation of import controls, and rising import prices also resulted in a marked rise in the value of imports in 1951. The higher reserves therefore were still equivalent to just over 5 months' overseas payments. In 1952 the continued import boom accompanied by a fall in export receipts brought the reserves rapidly down to £84 million, sufficient to finance only 3¾ months' payments. Many traders had over-stocked in relation to the immediate demand for the goods they had imported and this, with the introduction of exchange allocations, led to a fall in imports of nearly £30 million in 1953. With export receipts rising by a similar amount, the reserves were built up to £115 million, a sum equivalent to 5¾ months' payments.

743. In the latter part of 1954 and throughout 1955, with the relaxation and later removal of exchange allocations and the resurgence of inflationary pressure within the country, private imports again rose markedly. Despite high export receipts and some overseas borrowing, substantial deficits in the balance of payments followed. As a result, the exchange reserves fell to an amount equivalent to only $3\frac{3}{4}$ months' overseas payments in 1955. It is quite clear that deficits of the size incurred in 1954 and 1955 could not be sustained for long without gravely endangering the ability of this country to safeguard itself from the worst effects of any recession of trade in the future.

744. In view of our continued dependence on overseas trade, of the fact that export prices are at a high level, and of the obligation of Governments to attempt to maintain full employment even in the face of greatly reduced export incomes, it is a matter for concern that our overseas exchange reserves have been drawn down to such a considerable extent in the past two years. It seems evident to the Commission that, while export prices remain high, it would be desirable to rebuild the reserves gradually to a more adequate figure. We now proceed to discuss the means of controlling the balance of payments to achieve and maintain an adequate level of reserves.

Controlling the Balance of Payments

745. Balance of payments deficits arise when the amount of overseas exchange which New Zealand receives falls short of the amounts which are remitted overseas to buy imports or for other purposes. This may happen for several reasons, for example:

(a) Our export receipts may fall off, while our outgoings are maintained. This could occur either because we have less produce to send overseas or because persons overseas are willing to pay less than before for our exports.

(b) Our overseas payments may increase while our overseas receipts remain stable. This may occur either because our spending on imports has increased or because some persons have decided to make more investments than usual outside the country.

746. The balance of payments crisis of 1938 arose from a combination of a rise in external payments, a fall in export receipts, and large capital remittances from the country. The substantial deficits in 1951–52 and in 1954–55 arose from a marked upsurge of spending on imported capital and consumer goods, assisted by a large expansion of trading-bank credit. Fortunately, in both 1951–52 and 1954–55, export receipts were maintained at a high level.

747. Some witnesses at our hearings devoted much attention to the problem of the country's balance of payments. Several witnesses made suggestions for removing the current deficit and for maintaining equilibrium in the future. Some of these suggestions are considered in the following brief discussion of the means available to the authorities to control the balance of payments.

748. A balance of payments deficit may be overcome in several ways, the main methods being to:

(a) Increase the volume and quality of production and reduce costs in New Zealand.

(b) Restrain domestic expenditure on goods and services.

(c) Impose direct control over imports and exchange transactions.
(d) Raise the exchange rate.
(e) Raise tariffs against imported goods.
(f) Borrow overseas.
(g) Induce other countries to remove barriers to the sale of New Zealand's exports at more remunerative prices.

Increasing Production, Improving Quality, and Reducing Costs

749. The best method of controlling a balance of payments deficit (and inflation) would be to increase the production, improve the quality, and reduce the costs of the goods and services which the country produces. It is beyond the scope of this report to recommend how this should be done, although we believe that the adoption of the measures which we have recommended herein would contribute to greater efficiency in the economy as a whole. However, as a general rule, productivity increases relatively slowly, and the increase cannot be relied upon to correct a balance of payments deficit of any magnitude, especially if domestic spending is rising more rapidly than productivity.

Preventing Excessive Demand for Imports: Disinflation or Direct Controls?

750. As we have remarked, the major reason for the balance of payments deficits of 1951–52 and 1954–55 was that domestic spending expanded excessively in relation to the local goods and services which could be made available at current prices and the imported goods and services which could be provided out of the country's current overseas earnings.

751. In other words, the balance of payments deficits were merely symptoms springing from a more fundamental cause, an attempt by the country to live beyond its means by consuming and investing more than it earned by its current output. The main lesson from the experience of this period is that, if we are to avoid a recurrence of these problems in the future, the Government must adopt timely and appropriate fiscal and monetary policies to prevent excessive demand from being generated.

752. It was suggested by some witnesses, notably by the President of the Federation of Labour, Mr F. P. Walsh, that the current balance of payments deficit should be overcome by reimposing a detailed system of selective import control. Indeed, he went so far as to say that:

> If living standards, full employment, and Social Security as we know it now, are to be maintained, and the steady expansion of industry and the agricultural development so necessary to a young country such as ours, is to take place, immediate control of overseas exchange should be effected and a policy of import selection put into operation as soon as possible . . . Reserve Bank policy (on reserve ratio and discount rates) has been a complete failure and it could never be anything else. For all that the Reserve Bank can succeed in doing if it makes its ineffective policy into an effective one, is to produce unemployment and to stunt New Zealand's growth. If, however, the objective is full employment, and the maintenance and expansion of living standards, then import selection is the only possible permanent answer.

753. We do not believe that the experience of the last five years proves that to maintain a high level of prosperity and full employment it is necessary to retain direct controls over imports and exchange transactions permanently. We believe that, if adequate monetary and fiscal policies had been adopted promptly and applied resolutely, no serious

balance of payments difficulties would have arisen. We have made suggestions which we hope will help to ensure that more prompt and effective action will be taken in the future to control the level of demand in the national interest.

754. We do not intend to discuss in this report the political, administrative, and ethical arguments involved in considering whether or not to use direct controls over imports and foreign exchange. It is sufficient to say here that we recognise that there may well be occasions when it is essential in the national interest to impose direct controls. For example:

(a) We believe that it is essential to maintain direct control over capital transfers overseas.

(b) Since direct controls can effect a reduction of imports more quickly than the other methods available, there would be no alternative but to use them if the reserves of exchange fell to a dangerously low level, while balance of payments deficits continued and it was impossible to borrow overseas.

(c) There would be a strong case for their use if balance of payments deficits persisted after the level of demand had been reduced by fiscal and monetary measures to a point where any further reduction would cause serious unemployment in the country.

755. But the deficits of 1951–52 and 1954–55 occurred despite very high export prices and were accompanied by inflationary conditions internally. An attempt to meet the situation by import or exchange controls alone would not have dealt with the root cause of the problem – indeed, by preventing the high level of internal demand from being directed partly to imports, the controls would merely have aggravated internal inflation.

756. Mr Walsh acknowledged in evidence that the cause of the country's trade problem was excessive internal spending and that it was essential to reduce spending overall by appropriate budgetary policies and by credit restrictions.

757. As pointed out earlier, we are convinced that disinflationary fiscal and monetary policies are in the best interest of the country at the present time. If the Government is prepared to take adequate fiscal and monetary measures of the type recommended by us, there is every possibility that it will be able to correct our present balance of payment difficulties while maintaining a policy of placing as few direct controls as possible on external trade. If it is not prepared to take such measures, our reserves, already too low, will be further reduced and the Government may be compelled to institute a system of direct control over imports and exchange in order to prevent excessive depletion. However, if this were done and inflationary pressure were allowed to persist internally, it should be recognised that the community must necessarily continue to be confronted with rising prices and/or direct controls over domestic transactions, as well as the direct controls over external trade.

Varying the Exchange Rate

758. Some witnesses argued that more use should be made of variation of the exchange rate as a means of controlling the balance of payments in New Zealand. The following is an extract from the submission of Mr Colin Clark:

There appears to be quite a strong case for New Zealand having a flexible and freely moving exchange rate, rather than a fixed exchange rate with sterling. Exports represent a substantial proportion of New Zealand's national production, and will continue to do so. The world prices of some of New Zealand's leading exports are subject to considerable fluctuations, both upward and downward. Allowing the exchange rate to move means that the impact of such fluctuations upon the New Zealand economy, whether upward or downward, is reduced. This would almost certainly be advantageous.

There should be, of course, a forward exchange market, in which anyone concerned could get a firm quotation for purchases or sales of exchange to be made up to twelve months or more in the future.

A flexible exchange rate, at a time when export prices fell, would discourage imports, and thereby perform automatically some of what has at present to be done by legal regulation. This too would be an advantage.

759. Federated Farmers also recommended that, *after* steps had been taken to control inflation in New Zealand, the exchange rate should be freed.

760. While we recognise that it might be desirable, even necessary, to vary the exchange rate from time to time, we would not favour any attempt to institute a system of free and flexible exchange rates based upon the supply of exchange relative to the demand for it.

761. The Reserve Bank submission contained this comment:

It would be administratively difficult to operate in New Zealand a truly free market in which rates vary from day to day or from hour to hour. There is no market mechanism of this sort, such as exists in London or New York or the Continent. The dealers in New Zealand are the trading banks and the Reserve Bank. Rates might be fixed daily, but daily transactions are so erratic that it would be difficult to find a basis for fixing rates. There are also marked seasonal changes in receipts and payments, which would present difficulties.

762. In short, rates could not be allowed to vary in accordance with short-term fluctuations in the demand for and supply of exchange. The authorities would still have to decide whether a change was desirable in the circumstances and when it should take place.

763. Further, we consider that small and frequent changes in the exchange rate designed to correct the balance of payments would increase the uncertainty of overseas trade and encourage speculation. It should be remembered also that depreciation of the New Zealand pound, by raising the New Zealand price of imported goods, would give added protection to New Zealand manufacturers; appreciation, on the other hand, would expose them to greater competition from overseas. Frequent fluctuations would thus increase the uncertainties facing domestic manufacturing industry. In practice, these uncertainties could not be fully offset by forward exchange operations.

764. Again, changes in the exchange rate would inevitably be accompanied by changes in the distribution of income which might not be acceptable to important sections of the community.

765. If, for example, the New Zealand pound is depreciated in terms of sterling, primary producers' incomes are increased and the prices of imports are increased in terms of New Zealand money. Conversely, if the currency is appreciated, the primary producers' incomes are reduced as also are the prices of imports. The internal prices of New Zealand primary produce retained for home consumption would also increase with depreciation or decrease with appreciation of the New Zealand pound. An indication of the attitude of one major interest group to changes of the exchange rate was given in the evidence of Mr F. P. Walsh, President of the Federation of Labour.

766. Mr Walsh said that he held the view that variation of the exchange rate was a useful weapon to stabilise prices in New Zealand when *"we were on the up and up . . . In my opinion it would have given greater stability in that period and particularly to the people that I represent, the wage and salary earners. But to adopt that policy now it would mean that the wage and salary earners would have to carry the loss so I want to be quite frank that I would not support that policy under the present market trends of the world"*. From the viewpoint of sectional interest, the existence of substantial reserve funds held for the benefit of the primary industries in times of difficulty is another factor which would have to be considered before the exchange rate was depreciated to solve balance of payments difficulties.

767. A vital factor is that a change in the exchange rate cannot be considered in isolation or from a short-term point of view. Its repercussions upon domestic prices, incomes, and the money supply must be taken into account. Some comments of Mr Colin Clark are relevant. He drew attention to the *"risk at a time, for instance, in which a serious adverse balance of payments led to a fall in the exchange rate, which led to a rise in wages and other costs, which led to a further fall in exports, and so on, creating a vicious spiral. Such a possibility could be extremely dangerous. Everything turns on the method of adjustment of wages and other costs. If there is an automatic adjustment of wages to a Price Index, there is a danger of such a spiral, and therefore a case against a flexible exchange rate. New Zealand therefore can only consider policy on the matter of exchange rates in conjunction with wage policy"*.

768. In New Zealand, the Court of Arbitration, in making general orders, is required, *inter alia,* to take into account: "Any rise or fall in retail prices . . ." and "relative movements in the incomes of different sections of the community".

769. Both of these factors would be affected by alterations in the exchange rate. And even if minimum wage rates were not subject to the jurisdiction of the Arbitration Court, changes in the cost of living and in the distribution of income would still play a large part in their determination.

770. Under a system whereby exchange rates varied freely in response to changes in the balance of payments, a depreciation of the currency would have occurred as a result of the deficit in the balance of payments in 1954–55. But, by altering the distribution of income in favour of the farmers, already receiving high prices for their produce, and by raising costs and prices, a depreciation would undoubtedly have increased pressure for wage increases and aggravated the inflationary pressure already existing. Moreover, in these circumstances, it is doubtful whether the desired objective of correcting the balance of payments deficit would have been achieved.

771. For all the above reasons, we do not recommend the frequent variation of exchange rates (whether automatically or by Government action) as a method of controlling the balance of payments. Infrequent changes may be necessary, but their timing and extent must necessarily be left to the judgment of the Government, taking all its objectives and the existing circumstances into account.

Higher Tariffs, Overseas Borrowing and Securing More Favourable Treatment for Our Exports Overseas

772. Tariff policy is outside the order of reference of the Commission, and we do no more than mention higher tariffs as a possible method of correcting a balance of payments deficit. Overseas borrowing is considered later in this section of the report. It is beyond the scope of this report to consider the means of securing more favourable treatment or new markets for exports. However, our discussion of the International Monetary Fund and International Bank is relevant to this problem.

Internal Action to Correct a Balance of Payments Deficit: Summary

773. Many people regard any attempt to solve balance of payments problems by disinflation as totally unacceptable. Yet what are the alternatives? If, whenever they were faced with a deficit in their balance of payments, all countries met the problem by using import or exchange controls, raising tariffs, or by depreciating the exchange value of their currencies, the conditions of world trade would be chaotic and none would suffer more than New Zealand. It is in New Zealand's interest to preserve conditions of reasonable freedom of trade, reasonable stability of trade policy, and reasonable stability of exchange rates in the world as a whole; but our ability to argue that such policies should be followed by other countries is gravely weakened if we ourselves resort unduly to the measures which we deplore when they are used by others.

774. In any event, it is a mistake to believe that, if a country is running balance of payments deficits which it can no longer afford, it will avoid a fall in real income by raising barriers against imports or by depreciating its currency. If imports have to be reduced, people must do without the imported goods no matter what means are used to effect the reduction.

775. If balance of payments difficulties are due to internal inflation, the best way to get rid of them is to take steps to cure the inflation. If the difficulties are not due to internal inflation, and no outside assistance is available, the Government must choose from among import and exchange controls, higher tariffs, devaluation of the currency, or other measures designed to reduce spending as a means of correcting the position. Unfortunately, no general rules can be laid down as to what measures are most appropriate. Again, there is no substitute for judgment in choosing the course which is most suited to the prevailing political and economic circumstances.

B. PROTECTING THE ECONOMY FROM THE EFFECTS OF PRICE CHANGES OVERSEAS

The Impact of Price Changes Overseas on the New Zealand Economy

776. We have outlined in Section Five of this report the effects on the New Zealand economy of increases in export and import prices and we have concluded that these have been major factors responsible for the fall in the value of money which has occurred since 1934. On the other hand, in the absence of intervention by the authorities, a general fall in export and import prices would reduce prices and incomes, and, if continued, would curtail production and employment. This would be especially true if, as has been the case in the past, export prices fell further and faster than import prices. It is impossible to predict to what

extent export and import prices will fluctuate and when the fluctuations will occur. But there is no doubt that changes in export and import prices will occur in the future and the question arises whether there is any action which can be taken to protect the New Zealand economy from the worst effects of such changes.

Methods of Protecting the Economy Against Fluctuations Overseas

777. There are four main sets of measures available for use by Governments to counter the effects of price changes overseas. They are:

(a) Automatic variation of the rate of exchange.
(b) Occasional variation of the rate of exchange.
(c) Guaranteed price, floor price, or proceeds retention schemes.
(d) Monetary and fiscal policies.

Automatic Variation of the Rate of Exchange

778. The main proposal for a form of automatic variation of the rate of exchange put to the Commission was that submitted by Mr H. J. Kelliher and The Mirror Publishing Co. Ltd. This is discussed further in Section Eight of this report and in Appendix F, where the Commission gives its reasons for not recommending its adoption in New Zealand.

779. A less complicated scheme than that put forward by Mr Kelliher would be to vary the rate of exchange automatically in accordance with changes in an index of import prices, or of export prices, or of import and export prices combined. We do not believe that a scheme of this nature would be in the best interests of the country. Our reasons are similar to those given earlier in this section, in particular:

(a) The changes would increase uncertainty and speculation.
(b) A change designed to secure stability of prices might aggravate a current difficulty in the balance of payments.
(c) A change in an index of prices might obscure different trends of prices of the goods included in the index (e.g., wool prices might rise sharply while butter prices fell and an appreciation of the exchange rate in such circumstances might bear unduly harshly on butter producers).
(d) There is no reason to believe that alterations in the exchange rate based solely on changes in the prices of exported and/or imported goods would always be desirable in the light of current trends in other prices, in the distribution of income, in the profitability of important industries, and so on. In short, there are too many objectives of policy, and too many economic, social, and political considerations to be reconciled, for an automatic formula based on a limited index of prices to serve the best interests of society in all circumstances.
(e) We would not welcome the adoption of such a formula by major countries overseas. Since our interests are best served by relative stability of exchange rates in the world as a whole, we should maintain stable exchange rates ourselves.

Occasional Variation of the Rate of Exchange

780. The above remarks do not rule out all changes in the rate of exchange. Indeed, we feel that the changes made in 1933 and 1948 were fully justified in the circumstances of those times and had a most beneficial effect on the economy.

781. No definite and irrevocable rules can be laid down for exchange rate policy; decisions have to be made from time to time in the light not only of internal conditions and policies, but also of conditions and policies which prevail in the overseas countries with which we transact our business.

782. In the opinion of the Commission, no case has been made for changing the present practice. We consider that as a general rule the exchange rate should be kept stable, adjustments being made only to meet special circumstances.

Guaranteed Price, Floor Price, and Proceeds Retention Schemes

783. The key role of the farming industries and the important effect of fluctuations of farm prices in New Zealand's economy has been recognised by Governments during the period we have considered. Various steps have been taken to stabilise returns to farmers, through such means as the guaranteed price scheme for dairy produce, the stabilisation accounts, and later the support price scheme for meat, the floor price scheme for wool, and the wool proceeds retention scheme. (See Section Five of this report.)

784. The Commission does not view with favour any guaranteed price basis for farm products where the chief criterion of price is average cost of production and a "reasonable" standard of living for the producer; and where there is little or no regard to export prices. Such a procedure implies that, regardless of the circumstances, the community as a whole will be required to subsidise the particular farm product when any reserve funds built up in periods of favourable prices have been exhausted. Furthermore, releases from reserve accounts or the payment of a subsidy may be demanded at a time when export prices and farm incomes generally are still high, and the economy is suffering from overfull employment.

785. If the sums required were large, it would be impossible to allow the securities held on behalf of the producers to be sold on the open market. In all probability, they would have to be sold to the Reserve Bank or to the Treasury. If they were sold to the bank, there would be an increase in the volume of money as a result of the purchase of securities; if they were sold to the Treasury, the Government's overall surplus would be correspondingly reduced. In both cases the transaction could only add to inflationary pressures and cause increased demands for imports.

786. There appears to be more flexibility and merit in an equalisation or support price scheme which will counteract sharp rises or falls in prices, and as far as practicable level out the extreme fluctuations in farming returns.

787. The Reserve Bank observes:

In considering how and when reserve funds should be used to support farm prices, there is always a temptation to release money too soon. Decisions as to guaranteed or support prices should be based on the following points:

(a) The general state of the economy.
(b) The level of farm incomes in general.
(c) Relative changes (both recent and prospective) in prices of dairy produce, meat, and wool.
(d) Changes in the total and distribution of *real* national income (i.e., money income corrected for price changes).

(e) Forecasts as to whether the fall in export prices is temporary or due to some more deep-seated changes in world markets.

(f) Other financial and economic measures which have been or are likely to be adopted to deal with the economic situation.

The question of changes in real national income and the effect of the support scheme in altering the distribution of that income between different sections of the economy is of vital importance. If the fall in export prices brings about a decline in real national income and the support scheme has the effect of maintaining the real income of primary producers, this can be done only at the expense of other sections of the community and would cause considerable dissatisfaction. It will therefore be a matter of delicate judgment to fix a support price which will maintain the primary producers' share of real national income but not significantly increase it. What this means in practice can be decided only in the light of circumstances existing at the time.

788. Used in this way the present pool funds should provide reasonable protection for the primary industries. Released and spent into circulation by the farmers, they would benefit all sections of the community. On the other hand, additions to these funds might be necessary and desirable from time to time in periods of high export prices.

789. In the event of any sudden and steep rise in prices in any item of exports, which might be expected not to last long, consideration should also be given to freezing a portion of the increase and releasing the amount so withheld over a period of years as was done in the case of wool in and after 1950. Without measures of this sort, other sections of the community would no doubt claim a commensurate share of the inflated earnings of the primary producers concerned. If granted, their claims would add to costs and prices, and cause economic difficulties, and difficulties for the farming industries, when prices fell again.

790. However, we consider it important that any amounts withheld from the farmers should not be allowed to form the base of any expansion of credit and that additions should be made to our overseas reserves sufficient to provide for the demand for imports which must arise when releases are made.

The Role of Fiscal and Monetary Policies in Countering External Fluctuations

791. The extent to which fiscal and monetary policies may have to be used to counter the effects of changes in prices of exports and imports depends upon what action, if any, has been taken to vary the exchange rate or to stabilise farmers' incomes.

792. If, when overseas prices change, it is impracticable to counter the changes by varying the exchange rate, the changes in overseas prices must be reflected to some extent in the New Zealand economy. For example, it would have been quite impracticable to have prevented by domestic policies a substantial rise in the New Zealand price level as a result of the general but uneven rise in external prices which followed the outbreak of war in Korea. The objective of policy (fiscal, monetary, and stabilisation of farm incomes) in such circumstances, therefore, cannot be to prevent a rise in prices, but to ensure that spending in New Zealand does not expand excessively, and lead to a spiral of costs and prices out of line with overseas trends, to large numbers of employment vacancies and to eventual balance of payments difficulties. The means available to the Government and monetary authorities to achieve this end have been fully discussed in previous sections of this report.

Dealing with a Recession in Export Prices

793. Steps appropriate to deal with a fall in export prices expected to be temporary, would consist of measures to keep up the flow of imported goods and of measures to maintain spending in New Zealand.

794. The key to an effective full employment policy in New Zealand lies in maintaining adequate reserves of foreign exchange in times of prosperity, for employment and living standards can be maintained in the face of falling export receipts only if we can maintain an adequate flow of imports. Unless we could borrow overseas, we could maintain imports in the face of a fall in export prices or a deterioration of our terms of trade only by drawing on exchange reserves.

795. The type of domestic economic policy which might be adopted in such circumstances (i.e., where it is possible to maintain imports by drawing on reserves in a period of falling export prices which is expected to be temporary) is discussed in a supplementary statement to the Commission by the Reserve Bank on 19 September 1955:

No one's *real* income need be cut, but money incomes could (and probably should) fall to the extent that the consumers' price index has fallen – which would not be much. People whose incomes are relatively fixed would gain in real purchasing power. Farmers' incomes could be supported by use of reserve funds, and credit policy could be eased. Government revenue would fall only slightly, and the volume of Government expenditure could be maintained with little if any budget deficit. No tightening up of import control would be necessary, though there might be demands for more tariff protection if import prices fall more than do local costs.

In the circumstances assumed here, the use of more liberal credit policies would probably be needed, for two reasons. The first is to ensure that the needed inflow of imports is obtained. It is not enough to be *willing* to use reserves or external borrowing as a means of keeping up the inflow. There must also be the internal *demand* for the goods. Secondly, some measure to support demand is needed because otherwise the drop in export prices is likely to have a spiralling effect on incomes and spending.

If these conditions prevail it would largely be a case of "business as usual". The course of events should cause nobody to lose confidence.

796. If the recession were more severe it is unlikely that a drop in the volume of goods and services available for use could be avoided. The greater the reserves which had been built up, the less the drop would be. In such circumstances, it would be necessary for the community to reduce its spending to a level appropriate to the reduced volume of goods available. A reduction of spending would probably occur automatically as a result of loss of confidence by business men in the face of the fall in export prices and a major problem for Government might be to prevent this from becoming cumulative. It would then have to vary its fiscal, monetary, and farm stabilisation policies to ensure that spending was maintained as nearly as possible at the most desirable level, and that any loss of real income which was inevitable was spread fairly among the various sections of the community.

Conclusion on Protection of the Economy from Overseas Fluctuations

797. Although it is not necessary that the New Zealand economy should follow every fluctuation of economic activity in its major markets overseas, it is impossible to protect ourselves completely from such fluctuations. There is no simple formula or automatic device which will provide a satisfactory solution to the problems which arise from changes

in overseas prices. We must rely on the judgment of the Government and its economic advisers, in the circumstances prevailing at the time, to cushion the impact of these changes as far as possible and to prevent the New Zealand economy from itself accentuating the effects which spring from them.

C. OVERSEAS BORROWING

798. It is necessary to consider the desirability of borrowing overseas as an aid to policies designed to assist economic development, maintain economic stability, preserve equilibrium in the balance of payments, and protect New Zealand from the worst effects of recessions in export prices.

799. When the Central Government or private individuals or firms borrow overseas, or when persons overseas invest in New Zealand, the overseas exchange available to the country is correspondingly increased. Thus New Zealand can afford to buy more imported capital or consumer goods and services than it could if it had to live completely within its own resources. In other words, overseas borrowing and overseas investment in New Zealand permit part of the country's investment programme to be financed from the savings of people overseas, instead of by increased voluntary domestic savings (i.e., reduced consumption) by expansion of the money supply, or by higher taxation.

800. Overseas borrowing normally involves a contract to meet an annual interest charge and to repay the loan to persons overseas in the future, while overseas investment in New Zealand normally implies expectation of the payment of an annual dividend to the overseas investors. In either event, the sums involved have to be found from the country's future earnings of overseas exchange, and there is so much less available to buy imported goods and services for use in New Zealand at the time of payment.

801. Nevertheless, overseas borrowing and overseas investment may assist the growth of industries producing exports or making products of types which are at present imported. If this is so, the annual interest or dividend payments and the sums required for repayment may be more than offset by the additional earnings or saving of exchange. New Zealand, for example, could not have achieved its present volume of exports and standard of living so rapidly without the overseas funds which it borrowed in the past.

802. In deciding whether or not it should borrow overseas, the Government must take four main factors into account:

(a) The extent of the public and private capital development which it deems necessary in the public interest, and its relation to the voluntary private savings which can be expected, and the Government surplus which it is considered practicable to achieve.

(b) The existing state of the country's economy, labour market, balance of payments, and external reserves.

(c) The existing burden of the country's external debt.

(d) The country's probable ability to service additional debt in the future.

The Necessary Extent of Public and Private Capital Development

803. As remarked earlier, New Zealand's population is growing at a very rapid rate by comparison with the rate of growth in many other countries. To maintain real income per head, a very large programme of public and private investment has been necessary and will continue to be necessary for some time to come. There is no doubt that some of the investment projects which have been undertaken, particularly in the private sector, could have been deferred with benefit to the community as a whole. But, even if the less essential projects were weeded out, investment would still remain at a very high proportion of the national income.

804. In the view of the Treasury:

The minimum rate of investment required at the present time exceeds the savings which can be expected from a community which has become accustomed to high standards of living and therefore high levels of expenditure on consumption goods. In fact the level of savings has been high, but the capital requirement is now so heavy that it will be necessary to have recourse to some overseas borrowing to finance additional development.

The Present State of the Country's Economy, Internal and External

805. In the past few years the country has been suffering from continuous inflationary pressure and recurrent balance of payments difficulties despite a high level of export receipts. Overseas exchange reserves have now been reduced to such a level that it would be most unwise to draw them down any further to sustain the present volume of domestic spending.

The Present Burden of External Debt

806. The following table indicates that the payment of interest on New Zealand's public overseas debt now takes up a very small proportion of the country's annual export earnings.

Interest on New Zealand's Overseas Debt, 1911 to 1955

——	Amount	Percentage of Export Value
As at 31 March—	£(N.Z.)million	
1911	2·2	10·0
1920	4·2	8·2
1930	7·0	14·6
1940	5·7	9·5
1941	5·4	7·6
1942	5·4	7·8
1943	5·4	7·1
1944	6·6	8·8
1945	6·7	8·5
1946	7·0	7·9
1947	4·7	4·4
1948	4·7	3·4
1949	3·3	2·2
1950	2·8	1·8
1951	2·6	1·3
1952	2·6	1·0
1953	2·6	1·1
1954	2·6	1·1
1955	2·8	1·1

807. It is impossible to predict the future prospects for the sale of New Zealand's exports, or the extent to which the volume of exportable produce will be increased or the need for imports reduced as a result of the development programmes at present being undertaken in the public and private sectors. It is therefore difficult to judge the country's ability to service additional debt in the future. However, given the present low level of the overseas debt, and in the absence of any serious grounds for pessimism as to future export receipts, there would appear to be little danger in adding to the country's overseas debt commitments to some extent, if this is deemed desirable in the interests of stability, development, and the balance of payments.

808. However, in the Commission's view, undue reliance should not be placed on overseas borrowing as a means of achieving stability, both internally and in the balance of payments, at the present time, when export prices are high and our difficulties are principally due to internal inflationary pressure. The main attack on these problems must come from domestic monetary and fiscal policies, although overseas borrowing, in strictly limited amounts, may be useful as a supplement to appropriate domestic policies.

809. A further reason why too much reliance should not be placed on overseas borrowing at present is that suitable sources of borrowing are rather limited. Access to the London market, which is our traditional source of borrowing, is subject to permission by the United Kingdom authorities. Naturally the United Kingdom authorities must have regard to the effects of unrequited exports on the United Kingdom economy, and to the competing claims of other borrowers.

810. A special problem is that of borrowing from the dollar area. Fairly strict control has been maintained over dollar imports by successive New Zealand Governments but, except for a year or two following the "wool boom", the country has been in deficit in its balance of payments with the dollar area, thus necessitating net drawings by New Zealand on the sterling area's dollar reserves. Some other sterling area countries, notably Australia and India, which have also been in deficit with the dollar area, have borrowed dollars quite extensively in recent years, thus relieving to some extent the pressure on the sterling area's reserves. Since these reserves cannot be regarded as satisfactory at the existing level, and since the preservation of the sterling area system is in New Zealand's best interests, we consider it desirable for New Zealand to continue to restrict its drawings on the dollar pool as far as possible. **To this end, and on the assumption that dollar imports will be restricted to items which are essential to the country's economic development, the Commission considers that New Zealand could quite properly borrow in the dollar area in conformity with general sterling area policy.**

811. It would be desirable that, if possible, loan finance from overseas should be available, in addition to the country's reserves of foreign exchange, for use in a time of serious emergency. As indicated earlier in this section, New Zealand's ability to maintain a reasonable degree of economic stability in the face of a serious decline in export receipts depends on its ability to sustain deficits in the balance of payments in order to maintain the flow of essential imports. **The country's position in this respect would be strengthened to some extent if an arrangement**

could be made with the United Kingdom Government to extend short-term credits to New Zealand, if required, at a time of general recession. This arrangement would be of benefit not only to New Zealand, but also to British exporters at such a time. Preferably, such an arrangement should be made before the eventuality, which it is designed to meet, arises. We would, therefore, recommend that the Government discuss the question with the United Kingdom authorities at an early date.

812. No discussion of overseas borrowing would be complete without reference to the International Monetary Fund and the International Bank for Reconstruction and Development. The question of whether or not New Zealand should join these institutions is considered in the next section of the report.

D. THE INTERNATIONAL MONETARY FUND AND THE INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

Introduction

813. Since 1 July 1944, when the first exploratory International Monetary Conference was held at Bretton Woods, New Hampshire, United States of America, the question of joining the International Monetary Fund, which was subsequently set up, has been the subject of frequent controversy in New Zealand.

814. The Fund and its sister institution, The International Bank for Reconstruction and Development, were set up to provide machinery for international financial co-operation in the period of post-war reconstruction and thereafter. It was thought that international trade and financial transactions might well be hampered by temporary difficulties during progress towards freer international trade. The International Monetary Fund was therefore designed to assist in stabilising international exchange rates, to provide short-term financial assistance to member countries, and to hasten the removal of barriers to the free flow of international payments. The Bank was set up to promote international lending and to finance reconstruction and development projects.

815. The following statement by the Treasury summarises briefly the course of events affecting the Fund and the Bank since 1944:

The expectations of future trends on which the Fund was established were not justified by events. Instead of a period of progress towards freedom of international payments interrupted by minor difficulties which could be overcome by short-term assistance from the Fund—there developed a series of dollar crises owing to a continuing lack of balance between the dollar and non-dollar worlds. The Fund had neither the power nor the funds to cope with major crises and accordingly only minor use has been made of the Fund's resources.

During the last few years international trade has been more stable and the imbalance between the dollar and non-dollar world has been gradually reduced. Commonwealth countries have agreed on what has become known as the "Collective Approach" which has as its objective convertibility for sterling and a world of freer trade and payments. As progress is made towards this objective the International Monetary Fund is likely to play an essential and important part in international trade and payments, particularly in the event of a recession.

The prediction that there would be scope for an international organisation to supply capital for reconstruction and development has been amply fulfilled. There has been and there still is a great need for a flow of capital particularly from the dollar area and the International Bank is a useful instrument for increasing that flow of loan moneys.

816. The purpose of the International Monetary Fund are set out as follows in *"Article I – Purposes"* – of the Articles of Agreement.

(i) To promote international monetary co-operation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems:

(ii) To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy:

(iii) To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation:

(iv) To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade:

(v) To give confidence to members by making the Fund's resources available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity:

(vi) In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balance of payments of members.

The Fund shall be guided in all its decisions by the purposes set forth in this article.

Purposes of the Bank

817. The purposes of the Bank are:

(i) To assist in the reconstruction and development of territories of members by facilitating the investment of capital for productive purposes, including the restoration of economies destroyed or disrupted by war, the reconversion of productive facilities to peacetime needs, and the encouragement of the development of productive facilities and resources in less developed countries:

(ii) To promote private foreign investment by means of guarantees or participations in loans and other investments made by private investors; and when private capital is not available on reasonable terms, to supplement private investment by providing, on suitable conditions, finance for productive purposes out of its own capital, funds raised by it and its other resources:

(iii) To promote the long-range balanced growth of international trade and the maintenance of equilibrium in balance of payments by encouraging international investment for the development of the productive resources of members, thereby assisting in raising productivity, the standard of living, and conditions of labour in their territories:

(iv) To arrange the loans made or guaranteed by it in relation to international loans through other channels so that the more useful and urgent projects, large and small alike, will be dealt with first:

(v) To conduct its operations with due regard to the effect of international investment on business conditions in the territories of members and, in the immediate post-war years, to assist in bringing about a smooth transition from a wartime to a peacetime economy.

The Bank shall be guided in all its decisions by the purposes set forth above.

Membership of the Fund and Bank

818. There are now fifty-six members of both the Fund and Bank. U.S.S.R., Poland, Czechoslovakia, Liberia, Argentine, Portugal, Spain, Switzerland, Eire, and New Zealand are the more important non-members.

Should New Zealand Join?

819. Among those who favoured New Zealand joining the Fund and the Bank were Mr Fussell, Governor of the Reserve Bank, Mr Ashwin, Secretary of the Treasury, and Mr Whyte, Chairman of Associated Banks. Among those opposed to joining were the New Zealand Social Credit Association, Mr Otto (representing Mr H. J. Kelliher and The Mirror Publishing Co. Ltd.), Dr McElroy, and several other witnesses.

820. No witnesses who appeared before the Commission expressed themselves as being opposed to the purposes of the Fund. It appears to the Commission that a country heavily dependent on world trade like New Zealand has a great deal to gain from any agreements which go some way to achieving the objectives set out above. The history of the inter-war years demonstrated conclusively the folly of each nation's attempting to solve its trade and employment problems by measures which inevitably destroy the prosperity of others, and the desirability of international co-operation in the fields of trade and finance. Prima facie, therefore, there are strong grounds for New Zealand joining the majority of other countries in these attempts at co-operation in the field of international finance.

821. It is not intended in this report to outline in detail the organisation and rules of the Fund and Bank, since information on these matters is readily available in other publications. We regard our task to be a careful examination of the arguments for and against joining the Bretton Woods institutions.

Arguments Against Joining

Loss of Sovereignty in Respect of Exchange Rates and Exchange Restrictions

822. Members of the Fund lose most of their freedom to alter their exchange rates at will, in that they agree to accept the authority of the Fund in this matter and are required to consult with the Fund before taking action.

823. For changes up to 10 per cent in total the Fund can raise no objection. In respect of another 10 per cent the Fund must concur or object within seventy-two hours. For further alterations the Fund is entitled to a longer period (not specified) in which to declare its attitude. (Article IV.)

824. A member making an unauthorised change in the par value of its currency may be denied the use of the Fund's resources and may be expelled from the Fund in terms of Article XV (2) (b). France at one time was denied access to the Fund's resources, but no country has been expelled on these grounds.

825. The Fund must concur in a change of par values if it is satisfied that the change is necessary to correct *"a fundamental disequilibrium"*. This term is scarcely capable of precise definition and its interpretation is in the hands of Fund members.

826. That the interpretation of members is generous in practice is shown by the number of occasions on which member countries have been permitted to vary their exchange rates since the Fund came into operation. In this connection, Article IV specifically states that, provided a proposed change is to correct a fundamental disequilibrium, the Fund shall not object to a change in par values because of the domestic, social, or political policies of the member.

827. The Commission is of opinion that the original proposals not only provided for the requirements and limitations necessary to make the Fund workable, but also provided a generous measure of flexibility, thus ensuring that the rules were sufficiently adaptable to deal with special circumstances and contingencies affecting member countries.

828. Members of the Fund accept as an objective the elimination of exchange restrictions and discriminations, and in certain circumstances are required by the rules to obtain the approval of the Fund before introducing new exchange controls. We note, however, that member countries of the International Monetary Fund, in meeting the requirements of the Agreement, have not been prevented from taking any necessary steps to protect their balance of payments by way of import and other related controls.

829. As Mr Fussell said in evidence " . . . *if the course of events in the member countries during the years since they joined the Fund is studied, you will see what a high degree of flexibility and recognition of domestic affairs and ways of life have been recognised by the Fund*". Dr McElroy admitted that his former objection to joining the Fund because exchange rates were controlled had been modified as a result of the sympathetic way in which the rules had been interpreted over the years.

830. Both with regard to exchange rates and exchange restrictions, countries certainly surrender to the Fund part of their freedom of action but what happens in practice is rather that a degree of "sovereignty" is pooled by the member countries. There can be no freedom without restriction. In the opinion of the Commission, any limited loss of "sovereignty" or freedom involved is fully justified for:

(a) There is need for rules in international affairs, and an organisation to administer and enforce the rules. A limited surrender of freedom is essential to the maintenance of any ordered society.

(b) No country makes a unilateral surrender of its right to take exchange action without consultation; there is an equivalent surrender by all other member countries.

(c) Trade and commerce could not flourish among countries if they continually placed hindrances in the way of meeting current commitments, or, regardless of the interests of their trading partners, imposed exchange restrictions or depreciated their currencies. The rules of the Fund are therefore intended to prevent such unneighbourly practices, and in the course of time to remove hindrances already existing. Provision is made for the variation of exchange rates and imposition of exchange controls where this is clearly necessary, but the Fund makes it obligatory for the interest of others to be considered before action is taken. This is to New Zealand's advantage.

(d) The fact that fifty-six countries remain members of the Fund indicates that most countries regard membership of the Bretton Woods institutions as worth while.

(e) The fact that the approval of the Fund is required before certain actions can be taken by a member country does not mean that approval will rarely be given or arbitrarily withheld. In practice, the Fund has exercised its authority reasonably. This is shown by the 1949 devaluation by the United Kingdom and thirty-six other countries.

(f) New Zealand should not suffer any additional "loss of sovereignty" by joining the Fund and Bank. The principles of the Fund are not inconsistent with our trade and exchange policies. Mr Fussell said in evidence: " . . . *I do not know any country that carries out the ideals of the Fund more thoroughly than New*

Zealand does". In any case the Government has already undertaken to follow the principles of the Fund. At a recent session of the Contracting Parties to the GATT, New Zealand was granted a waiver from signing a special exchange agreement. The terms of the waiver recognised that New Zealand has taken no exchange action which has frustrated the intent of the GATT and that the New Zealand Government has given assurances that it will continue to act in exchange matters in a manner fully compatible with the principles of the International Monetary Fund and in accordance with the intent of the GATT.

(g) If membership should prove unsatisfactory, New Zealand would be entitled to withdraw from the Fund and the Bank. The process is simple. Any debts it may have incurred before withdrawing would, of course, have to be settled as provided in the Articles of Agreement and it would be liable for contingent liabilities to the Bank, so long as any part of the loans or guarantees contracted before it withdrew, were outstanding. There is, however, no present indication that there would be any need to withdraw.

831. **For the reasons given above, the Commission considers that the contention that a loss of sovereignty is involved is not a soundly based argument against joining the Fund and Bank.**

Domination by the United States or an International Financial Oligarchy

832. It was suggested to the Commission that the Fund and Bank are potent instruments of United States "imperialism" and that the aim of the United States is world domination especially in the sphere of trade and commerce. It is obvious that, irrespective of the existence of the Fund and of the Bank, the United States by virtue of its size and wealth is already dominant in the world economy. It is relevant to note, however, that, in the Fund, the United States has 27,750 votes (27·6 per cent of the total) compared with 25,900 of the Commonwealth countries (26,650 if New Zealand joined), but has only one executive director compared with four from Commonwealth countries.

833. Some Social Credit witnesses seemed concerned that the United States might, by manipulation of the Fund, force other countries to accept unwanted imports of American surplus goods and prevent them from taking adequate measures to protect themselves from deflation and unemployment. A realistic appraisal of the operations of the Fund since the war does not give any reasonable grounds for fears along the lines indicated above. Nor was any evidence brought before the Commission to support the allegation that the Fund or Bank were in any way dominated or controlled by "Wall Street" or by any conspiracy of international financiers, either independently or in association with communists.

834. From this aspect, New Zealand would surely be in a better position to place its views on international finance before the United States and other countries if it became a member of the Fund, than if it remained outside the main organ of international co-operation in this field.

Loss of Imperial Preference

835. It has been stated that membership of the International Monetary Fund would mean the end of our right to continue imperial preference. The Fund has nothing to do with imperial preference which comes within the scope of GATT (The General Agreement on Tariffs and Trade), of which New Zealand is already a member.

Financial Costs of Membership

836. If we had joined the Fund and the International Bank in 1945 we would have been required:

(a) To pay to the Fund and the Bank 10 per cent of our official holdings of gold and United States dollars, say about £1·6 million altogether.
(b) To make available to the Fund, in New Zealand currency and securities, £16·7 million.
(c) To make available to the International Bank, on call in New Zealand currency, £3·2 million.
(d) To make available to the International Bank, if borrowers default for substantial amounts (a remote contingency), up to £14·3 million.

837. If this scale of contribution were retained, our immediate payments would be small – approximately £1·6 million in gold or dollars. The present market value of the gold held by the Reserve Bank is £12 million. The New Zealand currency could (and normally would) be in the form of securities, not cash. The potential "burden" is remote and is not a great one, especially as any funds actually made available to the Fund or Bank would probably assist our exports, and would (in the case of the Fund) add to our own drawing rights.

Intervention by Fund in Internal Policies

838. Several witnesses feared such intervention, but the Fund has no authority over the internal policies of member countries. The assertion that the Fund attempts to bring about deflation or unemployment is groundless. The Governors of the Fund, too, are naturally interested in the well being of their own countries.

Court of Appeal

839. Mr Jordan, counsel for the Social Credit Association, laid great stress on the fact that there was no Court of Appeal from decisions of the Board of Governors of the Fund and he considered that the Court of Appeal might well be the Court of International Justice. The experience of the past nine years does not appear to have disclosed any need for such an appeal authority. As Mr Ashwin said, *"It is all based on trying to run it on a basis of co-operation"*.

Repurchase Requirements

840. When a member buys foreign currency from the Fund it pays in its own currency. The Fund's holding of that member's currency is thereby increased. Later the member may be required to repurchase its own currency from the Fund and may have to use gold, dollars, or other convertible currency for this purpose. If the currency originally purchased by the Fund was inconvertible, the provisions for repurchase could become onerous. However, the importance of this question will decrease as more currencies become convertible.

We Have Nothing to Gain

841. This view was voiced by several witnesses including Mr Otto, who said *"The main objection"* to our joining the Fund *"is that as far as trade and commerce are concerned we would have nothing to gain and as far as financial assistance and support are concerned it would be relatively insignificant . . ."*

Question:

There is no inherent vice in our joining but we have nothing to gain?

Mr Otto:

We have nothing to gain.

842. The Commission would comment that the traditional attitude of New Zealand with regard to international organisations has not been based purely on what we would gain, but rather in many cases, for example the International Labour Organisation, on what we could give. But from a purely selfish point of view we have a great deal to gain by lending every possible support to any organisation designed to foster or smooth the path of world trade, for there are few countries so dependent on trade with others as New Zealand.

Lack of Success

843. The view that the International Monetary Fund had failed to achieve its objectives and that many members had violated its rules and principles was given by some witnesses as a reason why New Zealand should not join. The Commission would make three comments on this view:

(a) The measurement of success is always difficult and it would indeed be a bold man who would assert that conditions of world trade and finance would today be better if the International Monetary Fund and the International Bank had not been established.

(b) It would not be reasonable to suggest that New Zealand withdraw from the United Nations because the success achieved has been less than many of us have hoped for.

(c) Like any organisation, the Fund has some members who do not fully observe its rules and principles. It is not always wise summarily to expel such members. Provided that there is some evidence of a desire generally to work towards the objectives of the organisation, it is often better to keep offenders within the framework of the Fund while making provision for continual consultation on the desirability of their policy. We do not therefore see any reason why New Zealand should stay outside the Fund because it has not expelled all members who have committed breaches of its rules.

Arguments in Favour of Joining the Fund and Bank

844. The above list of objections to joining is not exhaustive, but covers the main points brought to the notice of the Commission. Arguments in favour of joining the Fund and Bank are now reviewed.

845. The International Monetary Fund and the International Bank for Reconstruction and Development are a genuine attempt at international co-operation. New Zealand should certainly be able to subscribe to the main objectives which are:

(i) International co-operation.
(ii) Stability in exchange rates and orderly changes when necessary.
(iii) A reduction in exchange controls.
(iv) Provision of supplementary exchange reserves in time of need.
(v) Provision of capital for the development of less-developed areas.

Promotion of International Co-operation

846. On these points, Mr Ashwin said, " . . . *it does pay us to be a member of any international organisation that tends to promote economic stability in the world generally and particularly stability in world trade . . . We sell more than about 40 per cent of our production overseas*".

847. The Commission feels it highly desirable that there should be a forum, such as the Fund provides, for the continuous study and review of the problems of international finance, with the object of facilitating co-operation in financial matters among the nations and making recommendations in good time to deal with any serious difficulties which might arise. New Zealand should make its due contribution in this field and not leave it to others. The work which the International Bank is doing in providing finance, and a certain amount of technical assistance, to under-developed areas is also worthy of support.

Commonwealth Co-operation

848. As a Commonwealth member whose future is inextricably bound up with that of the United Kingdom, and as a member of the sterling area, it is in New Zealand's interest to join the International Monetary Fund. At present she is the only Commonwealth country which is not a member.

Availability of Loans from Fund and Bank

849. In the event of difficulties developing in regard to the balance of payments, we would have access through the Fund to additional monetary reserves (sterling and non-sterling currencies) of at least £18 million over a four-year period. Though not substantial, these could be of some value in the event of depressed export markets; and there is the likelihood (judging by recent experience of several member countries) that the Fund would allow us greater or more rapid access to its resources in special circumstances. The potential value of the Fund as a means of supplementing the exchange reserves of its members is not limited to the present rules and quotas. New Zealand might be accepted as a member with a higher quota than that agreed upon at Bretton Woods and thus be entitled to higher drawing rights. The Fund has already indicated that it can waive the limit on annual drawings, and quotas can be reviewed from time to time.

850. No witnesses questioned the success of the International Bank. Several Commonwealth countries, including India, Australia, and South Africa, have received substantial loans from it. New Zealand would be eligible for similar accommodation and as Mr Ashwin said, "*It might be*

a useful source of capital at a time when we cannot provide for our necessary development from our own resources or from money we can borrow in London". However, to be eligible to approach the Bank, we must first join the Fund. As mentioned in the last section, it may well be that, at the present time, when the United Kingdom has dollar exchange difficulties of her own, New Zealand, instead of drawing on the sterling areas dollar pool, could assist by securing part of her dollar requirements for capital goods by arranging a loan from the Bank.

Conclusion

851. The Commission is of the opinion that the arguments in favour of joining the International Monetary Fund and International Bank for Reconstruction and Development heavily outweigh the objections to that course, and recommends that New Zealand should seek membership of these two world organisations.

XI. Better Information as the Basis of Policy

A. STATISTICAL INFORMATION

852. During the public hearings of the Commission different witnesses expressed the opinion that an effort should be made to extend the collection of statistics in the economic field.

853. There was general appreciation of the work carried out in the past by the Department of Statistics, and the Commission joins in this appreciation.

854. Both the Governor of the Reserve Bank and the Government Statistician suggested a number of avenues of further desirable activity. After considering these suggestions, the Commission is satisfied as to the need for certain additional information and recommends the following extended programme of statistical collection:

(a) Stocks of commodities (including primary products) held by exporters, importers, manufacturers, and wholesalers.

(b) Surveys of hire-purchase and instalment trading, and operations of discount and finance businesses.

(c) Statistics of mortgage indebtedness.

(d) Statistics of capital expenditure, past and prospective.

(e) More comprehensive statistics of house and other building construction.

(f) Farm costs.

(g) Family living cost studies.

(h) Compilation of further industry sector accounts.

(i) Statistics of deposits with stock and station agents and other trading and financial concerns.

NOTE.—The acceptance of deposits is a form of finance subject to some risk unless special care is taken by the business concerned to preserve the necessary degree of liquidity in its assets to meet possible sudden demands for repayment. For this reason we consider that full information should be collected so that the authorities may be aware from time to time of the magnitude of the deposits and be in a position to take any necessary action should difficulties arise or if they were expected.

855. In connection with the collection of statistics in general, we would offer the following comments. There are a number of different Departments and agencies collecting statistics at present, with the result that a degree of irritation has developed in the business community due to indications of overlapping. We consider that an attempt should be made to channel all statistical inquiries as far as practicable through the Department of Statistics which has had very wide experience in eliciting information from the public.

856. If the foregoing suggestion were accepted, over-lapping would be largely avoided, relations between the collecting agency and the public would be improved, a more satisfactory response would be given to inquiries, and, ultimately, more reliable and up-to-date information would become available. We consider also that care should be exercised to ensure that returns are not requested at unnecessarily frequent intervals.

B. STATUTORY RETURNS BY THE TRADING BANKS

857. The Reserve Bank informed the Commission of a proposed amendment to the monthly statutory return which the trading banks are at present required to make. The Reserve Bank suggested that the following items should be included in the return:

PROPOSED STATUTORY RETURN

Principal Liabilities

1. Demand deposits in New Zealand.
2. Time deposits in New Zealand. [1]
3. Demand liabilities elsewhere than in New Zealand.
4. Time liabilities elsewhere than in New Zealand.
5. Bills payable in New Zealand. [2]
6. Balances due to other banks.
7. Other liabilities (excluding shareholder's funds).

[1] Including wool retention accounts which would continue as footnote.
[2] Bills payable settlement London, etc., including transit items to be included under 3 and 4. Bills payable in New Zealand may not be of sufficient importance for a separate heading.

Principal Assets

1. Reserve balances held at Reserve Bank of New Zealand.
2. Gold and bullion held in New Zealand.
3. Reserve Bank notes.
4. Subsidiary coin held in New Zealand.
5. Overseas assets in respect of New Zealand business:
   (1) In London.
   (2) Elsewhere than in London.
6. Aggregate advances in New Zealand:
   Aggregate discounts in New Zealand:
   (a) By London/Overseas Office.
   (b) In New Zealand.
7. Securities held in New Zealand:
   (1) Government.
   (2) Other.
8. Balances with and due from other banks.
9. Land, buildings, and furniture in New Zealand.
10. Bills receivable and items in transit in New Zealand. [1]
11. All other assets.

[1] Bills receivable and items in transit – London and overseas to be included under 5.

858. The Commission commends this suggestion. We propose, in addition, that the following items might be shown separately in the return:

(a) Reserve balances at the Reserve Bank required to satisfy current minimum reserve requirements.

(b) Reserve balances held in excess of the amounts required to satisfy current minimum reserve requirements.

(c) Liabilities to the Reserve Bank and/or the Treasury incurred in order to satisfy minimum reserve requirements.

(d) Other liabilities to the Reserve Bank and/or to the Treasury.

(e) An assessment of the amounts by which overdrafts of customers are in excess of the limits granted.

C. FORWARD EXCHANGE

859. The question of forward exchange has attracted considerable attention since 1950 when the administration began to dismantle the import control system. A submission on this question was made to the Commission by Mr P. Cropper, of Auckland, and Mr Kelliher devoted a short section to it in his detailed criticism of Reserve Bank policy.

860. Mr Cropper in a foreword to his submission claimed that:

> The condition of the New Zealand economy rests almost solely on receipts from the very large part of our national product which is sold abroad.

He offered the opinion that we could estimate very closely the volume of these exports and could make well informed calculations of probable returns but that:

> Nobody in the banking system or the Government can make a truly informed guess as to New Zealand's total forward commitments for exchange at any given moment, now that import control is largely removed.

861. Mr Fussell's examination at the public hearings on 28 September 1955 contains a passage bearing on this last point:

Question:

> I think the position is that our imports to date so far this year are pretty well a record, aren't they?

Mr Fussell:

> For the first seven months they were £138 million. The record figure is for the first seven months of 1952 when they were £139 million.

Question:

> Do you think that there is likely to be a reduction in the rate of imports for the remainder of the year?

Mr Fussell:

> All I can say is we are striving to make it so . . .

Question:

> Would it not likely be the position, Mr Fussell, that orders would already have been placed before now for those imports that are likely to come in for the remainder of the year?

Mr Fussell:

> I should think so . . . but the position is that we have no means of knowing what arrangements for payment importers have made because I can say this, that the sum total of the arrangements between the Reserve Bank and the trading banks that we are aware of, and the sum total of the arrangements for exchange between the importers and the trading banks, does not indicate that imports will be much in excess, if at all, of what they were last year.

And later on the same day:

Question:

. . . if the imports for this current year are to be kept within the figure of 1954 (£217½ million), those for the remaining four months of the year would not have to exceed £60 million?

Mr Fussell:

That is so, so far as payments are concerned.

[Note—Payments for imports for the calendar year 1955 were in fact £246·4 million.]

862. It appears to the Commission that a strong case can be made for some system which would, as Mr Cropper suggests, enable at least *"a well informed guess"* to be made.

863. Briefly, Mr Cropper proposed in his submission that:

(a) The trading banks should issue exchange reservations, on behalf of the Reserve Bank as required by customers in accordance with conditions laid down from time to time by the Reserve Bank. All such bookings of forward exchange in excess of £100 should be reported weekly by the trading banks in detail. An appropriate holding charge should be made for any exchange other than sterling bought forward by the Reserve Bank.

(b) No goods should be admitted into New Zealand unless exchange cover had been secured, except where no remittance was required in payment.

(c) A sliding "Scale of Margins" should be published setting the rates of cover required for bookings of exchange up to six months ahead. The scale would favour the booking of exchange well ahead of delivery dates. The rate of cover would be used to regulate the demand for exchange and thereby the rate of importations.

(d) The gambling instinct is so ingrained that provision should be incorporated in this plan to make gambling in exchange bookings unattractive, which could be done.

(e) The "Scale of Margins" should be such that regular traders would be required to furnish roughly half to two-thirds of the cover which they would have to find under regular letter of credit business of the same total volume, provided they booked their full exchange needs about six months ahead.

(f) Increases should be made in the "Scale of Margins" without notice, when it appeared that demands for exchange were exceeding estimated future receipts.

(g) So long as any particular currency is in short supply, "rationing" appears to be unavoidable and should be on the single consideration of essentiality.

(h) The future balance of payments position should be under constant review, once a system by which forward commitments could be accurately gauged was in force. Changes in the "Scale of Margins" should be made without delay whenever a decided trend up or down was apparent, but as seldom as practicable.

864. Mr Kelliher, in his submissions, gave a brief description of a scheme similar to that put forward by Mr Cropper and added this comment: *"In neglecting to institute a Forward Exchange Contract System the Reserve Bank has failed in its duty to the Commercial Community"*.

865. Mr Whyte, Chairman of the Associated Banks, stated under cross-examination that he was not in favour of a system of forward exchange. He suggested that it *"would be hamstringing trade . . . replacing another form of control for the one which we previously had"*. Mr Whyte also considered that *"the prime responsibility"* for the control of overseas exchange must rest with the Reserve Bank.

866. Mr Fussell was also questioned on this subject and raised the following objections:

(a) There would need to be a charge, and a penalty for not using the exchange.

(b) If the charge were low and penalty low, importers would ask for more than they could use.

(c) Alternatively, if the charge and penalty were high, importers would tend to import goods even if they were not really required rather than pay the Reserve Bank for nothing.

(d) The Reserve Bank would lose control of its own reserves by allocating ahead and thereby creating a firm obligation.

867. The Commission would comment in regard to these objections that forward exchange is a form of control but is only of a very general nature and therefore is not really comparable with import control or even exchange control. In our opinion the achievement of a reasonable foreknowledge of commitments warrants some sacrifice of freedom. Without any forward exchange system, and certainly without foreknowledge of commitments, the Reserve Bank appears in any case to have lost control of its exchange reserves. Under a forward exchange system the bank would have a much more accurate picture of what was going to happen.

868. Under a forward exchange system the Reserve Bank would at least allocate the funds, whereas under the present system it appears that importers can commit the Reserve Bank's funds without even notifying the Bank of what they have done.

869. The Commission does not suggest that forward exchange could or should operate as a system of import control, but does consider that it would give at least an indication or a guide to importers' outstanding orders. This is a matter on which little if any information appears to be available today. Such information appears to the Commission to be essential if the future policy of the Reserve Bank and the Government is to be soundly based.

870. Mr Cropper's scheme is too complicated and cumbersome. However, the Commission considers that some system of forward exchange is of vital importance in the control of overseas reserves and it therefore makes the following suggestion for consideration by the monetary authorities:

(a) All importers *before* placing or confirming any overseas order should notify their own trading bank and receive an acknowledgment in writing.

(Note—This acknowledgment slip would be numbered (e.g., B.N.Z. 1629) and this serial number would be the bank reference throughout the currency of the transaction.)

(b) The trading banks should notify the Reserve Bank each week of the value, number, and currencies involved in the acknowledgments issued, and the date when it is anticipated payment will be required.

(c) The penalty for failure by the importer to carry out this procedure should be a surcharge of, say, 10 per cent levied by the Reserve Bank on the exchange required when it is called for by the importer.

871. The Commission considers that this penalty would ensure compliance with the above requirements. The Reserve Bank would know week by week the extent to which the country's overseas funds were committed.

D. PROPOSAL TO ESTABLISH AN ECONOMIC RESEARCH INSTITUTE

872. The Reserve Bank made a strong recommendation to the Commission that an institution to conduct original research in the economic field should be set up in New Zealand. The bank emphasised that the present extent of such research was relatively small compared with what was needed and that it fell far behind what was being done in other countries.

873. It pointed out that there was no organisation in New Zealand comparable with the following overseas institutions:

The Economic Research Council in the United Kingdom.
The Nuffield College in the United Kingdom.
The National Institute of Economic Research in the United Kingdom.
The Australian National University.
The National Bureau of Economic Research in the United States of America.
The Brookings Institution in the United States of America.
The Central Planning Bureau in the Netherlands.
The Konjunkturinstitutet in Sweden.

874. Most of the work being done by Government institutions in New Zealand is limited to the day-to-day investigations necessary for the determination of important matters of policy, and there is need for long-term systematic research which would ultimately prove helpful to both Government and private enterprise.

875. The following are some of the matters suggested as suitable subjects for research:

(a) The relationship between export values and national income, and between national income and demand for imports.
(b) The relationship between savings, capital expenditure, and the balance of payments.
(c) Savings in general—how, when, where, and why?

(d) Factors affecting the rate of growth of production in New Zealand with particular reference to capital, population, and immigration.
(e) The impact on the New Zealand economy of changes in the terms of trade.
(f) Factors affecting:
  (i) Propensity to export.
  (ii) Propensity to import.
  (iii) Propensity to consume in New Zealand.
(g) Market analyses covering:
  (i) Broad factors affecting overseas markets.
  (ii) Demand determinants in the United Kingdom market.
(h) The effect of tariff and other forms of protection on the standard of living and the balance of payments.
(i) The effect of taxation on investment and enterprise.
(j) Financial organisation and agencies in relation to developmental requirements.
(k) Effect of wage changes in a dependent economy.
(l) Stabilisation policies—objectives, techniques, and effects.
(m) The administration and effects of price and other controls.
(n) The effects on the economy of hire-purchase and other instalment trading.

876. The Governor of the Reserve Bank expressed the view that such research would best be carried out by an *"absolutely independent institution"* rather than, for example, as a branch of the Reserve Bank, although the bank was prepared and willing to undertake the responsibility.

877. We are satisfied that there is need for such an organisation, of modest size and scope commensurate with our population and financial resources. We are most firmly of the opinion that it should be a completely independent body, and not an appendage of the Reserve Bank or any similar concern.

878. We do not envisage the organisation as a further addition to the group of authorities already collecting statistics in this country. Its primary function would be economic research. Any additional statistics necessary for its work should, as far as possible, be obtained through the Department of Statistics.

879. From the viewpoint of economy in the use of existing facilities and of the desirability for relative independence, it appears to the Commission that the most suitable arrangement would be for such an organisation to be attached to the Economics Department of one of the University colleges. The appropriate institution would be Victoria University College because of its situation in the capital city where close contacts could be established with Government Departments, the Reserve Bank, and with the head offices of many business concerns.

880. We consider that such a research institute should be financed by contributions from the Reserve Bank, the Department of Statistics, Victoria University College, and any other bodies such as Chambers of Commerce, Manufacturers' Federation, Bureau of Importers, Retailers' Federation, organisations of workers and employers, trading banks, and any private concerns which may be sufficiently interested to give the venture material support.

881. It seems to us that a body functioning in the independent manner in which the Council for Educational Research conducts its activities would serve the purposes contemplated.

882. We recommend therefore that steps should be taken to establish an Economic Research Institute to undertake investigations in the fields and on the lines set out above.

XII. Co-ordination of Policy

A. STATUTORY DEFINITION OF THE RELATIONSHIP BETWEEN THE GOVERNMENT AND THE RESERVE BANK

883. Before 1930 it was widely held that central banks should be free from Government control except the very broad direction that could be incorporated in legislation. In practice, because of personal and other factors, some central banks enjoyed more, and others less, independence than strict interpretation of the legislation seeemed to allow. The framers of the statute setting up the Reserve Bank of New Zealand, however, clearly contemplated considerable independence for the Reserve Bank.

884. The *Reserve Bank of New Zealand Proposal,* a pamphlet published in 1933 over the signature of the Right Hon. J. G. Coates, includes this passage:

> The State prescribes the system—be it gold standard, sterling exchange, or any other standard—and the duty is cast upon the bank to control the operation of that system.

885. The same pamphlet quotes Sir Ernest Harvey, a director of the Bank of England, as saying in 1927:

> A central bank in its management and policy should be free from government controls and the influence of politics.

886. In line with these views, section 17 of the Reserve Bank of New Zealand Act 1933 gave the Reserve Bank considerable autonomy in monetary policy:

> It shall be the primary duty of the Reserve Bank to exercise control, within the limits of the powers conferred on it by this Act, over the monetary circulation and credit in New Zealand, to the end that the economic welfare of the Dominion may be promoted and maintained.

887. The experiences of the depression brought a substantial change of opinion towards increasing the responsibility of Government for monetary policy with a corresponding lessening of the autonomy of the central banks in such matters. This change in outlook was a necessary accompaniment of the wide acceptance by Government of greater responsibility for the general control of the economy.

888. Despite the terms of section 12 of the 1933 Act, the Governor of the Reserve Bank said in his 1935 annual report to shareholders:

> The Board accepts the view that the ultimate responsibility for the monetary policy of the Dominion must rest with the Government of the day, but holds that it is the duty of the Bank to tender to the Government impartial advice on monetary and financial matters and to exercise its own judgment in carrying out those functions entrusted to it.

889. How this change of opinion has developed and how it has been reflected in legislation establishing or affecting central banks is shown in the following extract from *How Money is Managed* by Paul Einzig, published in 1954:

To the generation that has grown up since the suspension of the gold standard in 1931 it may appear almost incredible that a quarter of a century ago many Central Banks had practically a free hand in deciding the choice of the means of their country's monetary policy, and that very often they determined even its ends. Today the only power left in the hands of the Central Banks is the implementation of monetary policy decisions taken by Governments. It is only in the sphere of the technique of monetary practice that Central Banks still have a reasonably free hand.

890. The Reserve Bank of New Zealand Amendment Act of 1936 appears to have confirmed legislatively the allocation of responsibility set out in the extract from the 1935 annual report cited above. The relevant portion of section 10 (1) of the Amendment Act, described in the marginal note as *"Restatement of general functions of Reserve Bank"* reads:

It shall be the general function of the Reserve Bank, within the limits of its powers, to give effect as far as may be to the monetary policy of the Government, as communicated to it from time to time by the Minister of Finance. For this purpose, and to the end that the economic and social welfare of New Zealand may be promoted and maintained, the Bank shall regulate and control credit and currency in New Zealand . . .

891. Apparently even the degree of control over the Reserve Bank's operations given by the above amendment was not considered adequate by the Government, because in 1939 the following additional provision was enacted:

Section 2. In the exercise of their functions and powers under the principal Act the Governor and the Board of Directors shall have regard to any representations that may be made by the Minister of Finance in respect of any functions or business of the Reserve Bank, and shall give effect to any decision of the Government in relation thereto conveyed to the Governor in writing by the Minister of Finance.

892. It seems that this section enabled the Government not merely to dictate general monetary policy, which it could already do under the 1936 amendment, but also, if it so desired, to have the power of final decision, in the event of any difference of opinion between the Government and the Reserve Bank, as to how any functions or business of the bank were to be carried out.

893. The Reserve Bank of New Zealand Amendment Act of 1950 made no change in that portion of the 1936 provision requiring the bank to *"give effect as far as may be to the monetary policy of the Government"*. It, however, repealed section 2 of the 1939 amendment and substituted the following provision:

Section 3 (1). In the exercise of their functions and powers under the principal Act the Governor and the Board of Directors shall give effect to any resolution of the House of Representatives in respect of any functions or business of the Reserve Bank.

894. Both the Governor of the Reserve Bank and the Secretary to the Treasury expressed the view that in the event of any disagreement between the bank and the Government as to monetary policy, the bank could refuse to comply with a Government direction and could force the Government to obtain a resolution of the House of Representatives. The following extract from the transcript of evidence shows the attitude of the Governor of the Bank on this question:

Question:

Supposing the Government of the day – whatever Government it was – decided on a wholesale creation of credit, and said "That is our monetary policy" and conveyed that to you through the Minister of Finance. Do I take your answer as meaning that legally you think you could resist that communication of the Government's intention?

Answer:

I am convinced that I could, and I certainly would.

895. We think it is at least open to question whether the legal position is consonant with the attitude of the Governor of the Reserve Bank. Whatever the intention of the 1950 amendment, we are not satisfied that it modified in any way the provision of the 1936 amendment, which directs that the general function of the bank is *"to give effect, as far as may be, to the monetary policy of the Government, as communicated to it from time to time by the Minister of Finance"*.

896. We now examine the provision requiring the Governor and the Board of Directors of the bank, in the exercise of their functions and powers under the Act, to give effect to any resolution of the House of Representatives. If this provision is intended to relate to major questions of monetary policy – such as any expansion of credit decided upon by the Government – it could prove very cumbersome at a time when Parliament was not in session. Again, there are important questions of policy such as alterations in the exchange rate upon which it is impracticable to have discussions in Parliament before action is taken. Further, the section does not provide any assurance that the views of the Reserve Bank would be necessarily or fully publicised. It is significant that the Governor of the Bank stated that he did not think the section in question would ever be invoked in practice.

897. We suggest that the Reserve Bank of New Zealand Act be revised to make clear and explicit the respective functions of the Government and of the bank in relation to monetary policy. In our view, the Government must accept full and final responsibility for all decisions of policy in this field. We consider, therefore, that there should be no provision requiring a resolution of the House of Representatives to enable the Government to give directions to the Reserve Bank. In our view any such provision merely detracts in the public mind from the full and final responsibility of the Government in matters of monetary policy.

898. In essence, our view is that the terms of the Reserve Bank of New Zealand Act do not allocate the responsibility for monetary policy with sufficient clarity. Indeed, the Reserve Bank stressed to the Commission the need for *"clarification of the statement of the functions of the Bank"*. We recommend legislation to make it clear and explicit that:

(a) It is the function of the Reserve Bank to give effect to the monetary policy of the Government as communicated to it by the Minister of Finance.

(b) The bank is to advise the Government on matters relating to monetary policy, banking, and foreign exchange.

(c) The bank is to keep the Government fully informed about the measures it is adopting or proposes to adopt to give effect to the monetary policy of the Government.

(d) If there is any difference of opinion between the bank and the Government as to the measures adopted or proposed to be adopted under (c) above, the bank is to give effect to a decision of the Government conveyed to it in writing by the Minister of Finance.

(e) The Government is to decide such important questions as exchange rate policy. The Government, and not the bank, is to have the final authority to determine the London - New Zealand exchange rate. (At present the legal right to fix the exchange rate rests with the bank by virtue of section 16 (3) of the 1933 Act.)

(f) The Government is to have the power to initiate and direct a change in the reserve ratio. (At present section 45 (2) of the 1933 Act provides for changes to be made *"by the Governor of the bank acting with the authority of the Minister of Finance".)* We consider that the bank should have power to initiate changes in the ratio and that the Minister of Finance should also have that power which he could exercise if the bank did not initiate any change which he considered necessary. Such a provision would make it quite clear that the ultimate responsibility for the level of trading-bank advances rests with the Government.

899. We consider that statutory amendments along the above lines would make it quite clear that the full responsibility for decisions upon monetary policy rests with the Government; and that the functions of the bank are those of an adviser on monetary policy, and of an instrument for carrying out the Government's monetary policy.

900. In respect of reserves of overseas funds, section 17 (1) of the 1933 Act as substituted by section 4 (1) of the amendment Act of 1950 provides that *"it shall be the duty of the Bank to maintain reserves which, in the opinion of the Board of Directors, will provide a reasonable margin for contingencies, after taking into account prospective receipts and disbursements of overseas funds, and having regard to the economic position within New Zealand"*. In our opinion this is not a responsibility which should properly be imposed upon the Reserve Bank when so many of the policy decisions which affect the state of our reserves of overseas exchange are made not by the bank but by the Government.

901. Along with certain other amendments which are discussed elsewhere in this report, the Reserve Bank suggested that the *"existing powers of the bank in respect of exchange control, which are provided in emergency regulations, could be provided in the Reserve Bank Act on a permanent (but permissive) basis"*.

902. We agree that the Government's power to control overseas exchange transactions should have the direct authority of statute rather than the mere authority of regulations (Finance Emergency Regulations). It is widely recognised that control of capital transactions is necessary as a permanent feature and in our view there should be a statutory provision empowering the Government to control current transactions as well. This appears necessary because of the possibility of sudden crises. The detailed provisions could be prescribed by regulation.

903. While any decision to adopt, abandon, or modify exchange control is a question of Government policy, in our opinion the administration of the policy should be in the hands of the Reserve Bank as, of course, it is at present.

904. The following passage from *Central Banking* by M. H. de Kock ably summarises the main principle which should be followed in the revision of legislation relating to the respective spheres in monetary policy of the Government and the Reserve Bank:

While the Government admittedly should lay down the monetary policy of the country, the central bank is obviously in the best position to assist the Government in the formulation and carrying out of such policy. From this point of view alone, it is in the interests of the Government and the country as a whole to get independent advice and an objective judgment from the central bank of such vital and complicated matters as money, banking and exchange.

905. We consider that the Government must retain the right of final decision upon questions of policy, and the right to detail the measures adopted to give effect to such decisions. At the same time it is the responsibility of the Reserve Bank that it should offer to the Government of the day objective, competent, and fearless advice on all questions of monetary policy.

B. PROPOSAL TO ESTABLISH AN ECONOMIC ADVISORY COUNCIL

906. Written submissions presented by Mr H. J. Kelliher and The Mirror Publishing Co. Ltd. incorporated a proposal for the establishment of a permanent *"Council of Economic Advisors"*.

907. It was suggested that the Council should be: *"an independent authority . . . responsible directly to our elected Parliamentary Representatives through Cabinet, and performing the task of co-ordinating all spheres of economic and financial activity"*.

908. The following additional extracts from Mr Kelliher's submission will serve to convey his conception of the constitution and functions of the Council:

The Council of Economic Advisors should be similar in status to Judges of the Supreme Court – who are high ranking public servants outside of and above politics, not subject to Party pressure not dependent on votes, and of such professional standing as to assure the public of their probity and integrity. For the purpose of assuring continuity of policy, members of the Council should be appointed for a minimum term of say 7 years, so that the term of office of each one of them would extend over two triennial elections.

In carrying out the economic and financial policy of the Government of the day, the Council should be directly responsible to Cabinet and not to the individual Ministers whose portfolios might be affected by its decisions.

In fulfilling its obligations under its Statute of Establishment, the Council of Economic Advisors might on occasion come into such conflict with Cabinet on matters of economic or financial policy, as could not be resolved by discussion and conciliation. In such an event it would be necessary for the Council to have the right of recourse to the House of Representatives so that the subject matter of the dispute could be examined and debated by the elected representatives of the people. The procedure for the resolution of such conflict would be similar to that contained in the Central Bank legislation of the Netherlands and that of Australia.

909. It was suggested that the appropriate functions of the Council could be:

1. General supervision of the banking policy of both the Reserve Bank and the Trading Banks, with a view to fostering the restoration of traditional freedoms between banker and client, and the restoration to the Crown of the exclusive right of issue of money through its Central Bank.

2. In accordance with current economic needs, securing the adoption of comprehensive policies designed to achieve the required level of current savings having regard to investment needs, achieving the effective mobilisation of such savings, and achieving its allocation to the most desirable and necessary investment purposes in the Public, Local Body and Private Sectors.

3. Supervising of the operation of insulation techniques so as to achieve the most desirable level of those incomes, costs and prices which are affected by external forces; and to this end to determine an equitable co-ordination of the income decisions of various producer organisations – thus achieving long term stability in primary production, with the necessary incentives and dis-incentives in respect of both production and marketing.

4. Co-ordinating the policies of the various wage fixing authorities in the implementation of a "Productivity Wage" system, and fostering the implementation of a State policy of guaranteed full employment.

910. In reply to questions, however, Mr W. S. Otto, who was Mr Kelliher's witness, made it clear that the Council would be set up for the purpose of *"advising in the co-ordination of the economic and financial policy of the Government for the time being"*. Mr Kelliher cited in support of his proposal a statement by Professor H. Belshaw, that there was *"need for an advisory agency of Government, not simply Treasury, to analyse economic trends and structural changes on the basis of which an economic budget can be framed"*.

911. Mr Otto also quoted *"with very great approval"* the following extract from a pamphlet issued by the National Party prior to the 1949 general election:

In the campaign for honest money we will place responsibility for control of credit and the maintenance of a stable price level in the hands of a non-political currency commission with judicial status.

912. While the Commission is not prepared to recommend the adoption *in toto* of the foregoing proposals, it is convinced that it would be desirable to set up an Economic Advisory Council.

913. We are of the opinion that, while the Government must govern and take full responsibility for its administration, it is entitled to receive all possible assistance by way of advice before decisions are made upon the many and ever-increasing number of difficult and complex economic questions which come before it. In considering legislation to be submitted to Parliament, there also appears to be a greater need than formerly for thorough preliminary analysis because of the abolition of the Second Chamber.

914. We suggest as a possible basis the following constitution:

(a) The Council to consist of five independent permanent members of unimpeachable integrity, not otherwise actively associated in any business or Government activity, but eminently qualified by virtue of past attainments and experience in economics, banking, and commerce.

Note.—We would see no objection to the nomination of employees provided they are granted leave of absence without pay while serving as members of the Council.

(b) The members to be appointed by the Governor-General by Order in Council after the receipt of nominations made in the following manner:

(i) Two to be nominated by the Minister of Finance.

(ii) Two to be nominated by the Senate of the University of New Zealand.

(iii) One to be nominated by the Associated Banks in New Zealand.

NOTE.—In proposing the sources of nomination we have not mentioned the Reserve Bank or the Treasury as we regard the Minister of Finance as being representative of those institutions.

(c) The members to be appointed for a minimum of five years.

915. We propose the powers, duties, and functions of the Council should be:

(a) To act purely as an advisory agency without administrative duties of any kind.

(b) To analyse the entire economy and to review the economic situation from time to time in the light of changing circumstances.

(c) To advise the Government on appropriate economic policies.

(d) To present a report annually upon the state of the country's economy which shall be laid before Parliament.

(e) To submit supplementary reports from time to time when the Council deems fit to do so, such reports also to be laid before Parliament.

(f) To make confidential reports on any economic, monetary, banking, or fiscal question at the request of the Minister of Finance or of Cabinet.

(g) To confer with the Minister of Finance or Cabinet when required.

(h) To have power to call upon any Government Department, the Reserve Bank, any trading bank, and any savings bank for such statistical or other information as it may require to enable it to perform its functions.

(i) To initiate and recommend avenues of additional economic research.

916. We believe that such a Council would also serve certain aspects, which are acceptable to us, of the proposals made to the Commission by the New Zealand Social Credit Association Incorporated and Mr J. Hogan.

917. We recommend accordingly the establishment of an Economic Advisory Council upon the foregoing lines.

C. THE RELATIONSHIP OF MONETARY POLICIES TO BUDGETARY AND OTHER ECONOMIC POLICIES

Introduction

918. We noted in the historical review in Section Three that, during the period 1935 to 1939, both budgetary and monetary policies were directed towards the elimination of serious unemployment, and that the combined policies of increased Government expenditure, expansion of credit, and lower interest rates exercised a considerable influence towards economic recovery, reinforcing as they did the effects on the New Zealand economy of improvements in overseas conditions.

919. During the war, monetary policy played only a minor role. The main methods used by the Government to influence the economy and the price level were direct controls and budgetary policy. A comprehensive series of direct controls was supported by a budgetary policy

designed to remove from the hands of the general public as large a proportion as possible of the increasing flow of purchasing power in New Zealand arising from war expenditure and from substantial surpluses of exports over imports.

920. The post-war years saw military expenditure replaced by expanded private and Government capital expenditure as a powerful internal cause of inflation. Rising overseas prices and, from time to time, export surpluses also contributed substantially to the pressure. Up to 1949, because of the use of direct controls, and continued high taxation and borrowing from the public, major use of monetary policies was considered unnecessary.

921. Thus between 1935 and 1949, the economy responded first to a combination of budgetary and monetary policies and later (during wartime and the few years thereafter) to a combination of direct controls and budgetary policy. Since 1949 the strong inflationary influence of rising overseas prices has continued, with sharply rising private capital investment. We have no doubt that from 1950 onwards (when many direct controls had been discontinued) the economy would have benefitted considerably from the application from time to time of stronger monetary and budgetary policies designed to hold down the general level of demand for both consumer goods and services and for capital expansion.

Effects of Establishing the Reserve Bank

922. Before discussing the use of budgetary policy we recapitulate briefly the effects of the establishment of the Reserve Bank on the respective spheres of responsibility of the Government, the Reserve Bank, and the trading banks:

(a) The trading banks were relieved of direct responsibility for the adequacy or otherwise of the total reserves of overseas exchange held by the banking system.

(b) The effective factor limiting the ability of the trading banks to increase advances in New Zealand was changed from the overseas exchange held by the trading banks to the balances held by the trading banks at the Reserve Bank.

(c) Because of the operation of the Reserve Bank, the trading banks could no longer by their own actions place an upper limit on total bank credit in New Zealand.

(d) On the other hand the Government now had power to expand the level of bank credit in New Zealand by borrowing from the Reserve Bank to finance Government expenditure and to contract the level of bank credit by repaying its debt to the Reserve Bank from an overall surplus of taxation and other receipts over Government expenditure.

(e) Likewise the Government acquired power to expand the lending base of the trading banks by borrowing from the Reserve Bank and spending the money, and to contract the lending base by repaying (from taxation or other moneys received from the public in New Zealand) the Government debt to the Reserve Bank.

(f) The Reserve Bank was empowered in 1936 to enlarge or contract the effective lending base of the trading banks by varying the reserve ratio, with the approval of the Government.

923. The effect of the above changes was to remove from the trading banks the direct responsibility for the overall level of bank credit in New Zealand. Deliberate control by the Government thus replaced the automatic imposition of an upper limit through the need of the trading banks to maintain their own reserves of overseas exchange. Government control both of the total bank credit in New Zealand and of trading-bank advances is exercised through the Reserve Bank.

The Control of Total Trading-bank Advances

924. Although the Reserve Bank has been in operation for over twenty-one years, it was not deemed necessary to place any restraint on the upper limit of trading-bank advances until after 1950.

925. In January 1950 the trading-banks' balances at the Reserve Bank amounted to £89 million, whereas the statutory minimum deposit of 7 per cent of free deposits and 3 per cent of fixed deposits amounted to only £12·5 million. In such circumstances, it was clearly the responsibility of the Reserve Bank to ensure that the very liquid position of the trading banks was not used as the base for an undue expansion of trading-bank credit.

926. To say this does not in any way lessen the obligation upon the trading banks to act with responsibility and, in particular, to co-operate in whatever policy is laid down by the authorities. Neither does it detract from the responsibility of the Government to support its own monetary policy by budgetary and other measures.

Wider Use of Budgetary Policy

927. We have commented on the use of budgetary policy to overcome unemployment and later to contribute to wartime stabilisation. We now examine the change to the general use of the Budget as an instrument of economic policy over the last twenty-five years.

928. Paul Einzig explains in *How Money is Managed* that:

> The nineteenth century idea of a sound Budgetary policy was that its aim must be simply to keep down expenditure, cover it with the aid of taxation, and, if possible, produce a revenue surplus for the gradual reduction of the public debt.

In other words, the aim of budgetary policy was mainly to keep the cost of government down to a minimum and to levy only enough taxation to cover that cost.

929. The deliberate and systematic use of the Budget to influence the level of spending and of economic activity generally is a comparatively new development which received much impetus during the 1930's, when Governments deliberately budgeted for deficits as one of the means of overcoming economic depression, by increasing the amount of purchasing power in the hands of the people. Einzig also indicates that the use of the Budget to further general economic aims arose partly because it was found during the depression that the traditional means of monetary policy did not produce the desired results:

> The strength of the case for supplementing conventional measures of monetary policy by budgetary measures came to be realised during the thirties, as a result of the evidence showing that the conventional measures were largely ineffective in the prevailing conditions. One country after another tried in vain to bring about a trade revival with the aid of the time honoured device of "cheap money".

It was found that low interest rates signally failed to induce producers and consumers to borrow and spend. The need for direct Government intervention to stimulate trade by means of public expenditure came to be realised in many countries.

930. The fundamental reason for employing both monetary and budgetary policies and for fully integrating them is, therefore, that under modern conditions neither monetary policy nor budgetary policy is by itself an adequate means of discharging the very wide tasks which face the modern State, including the maintenance of full employment, stabilising the price level, and controlling the demand for imports.

931. Any degree of restraint imposed by monetary policies on the expansion of commercial and industrial activity in New Zealand could be completely nullified by the Government's own financial operations if its fiscal policy ran counter to its monetary policy. Credit restraint imposed to reduce the demands for consumer goods and services could, for example, be made ineffective by a Budget deficit. On the other hand, it could be strongly reinforced by a Budget surplus through which purchasing power could be taken out of the hands of the public.

932. In evidence before the Commission very great stress was put upon the use of monetary policy and particularly on the policy of restricting trading-bank advances and raising interest rates in order to limit both the demand for imports and upward pressure on prices in New Zealand. **While we regard these monetary policies as essential instruments of economic policy, we are convinced that monetary policy is by no means the only instrument available to the Government. Nor is it the most important instrument.**

933. In certain circumstances it is not enough for the Government to give attention only to the total volume of money and credit. It must also control in various ways the extent of the credit granted in particular sectors of the economy. As we have pointed out elsewhere, the adoption of appropriate policies in such fields as public finance (including housing finance), interest rates, and capital issues would ease considerably the pressure on the banks for additional credit and reinforce Reserve Bank measures to limit the expansion of credit.

934. To a very large extent the Government must pursue its broad objectives by influencing the general level of demand in the community. To do this it has to secure recognition that a basic purpose of taxation and of Government borrowing should be to reduce purchasing power in the hands of the public which would otherwise be excessive. Similarly, in appropriate circumstances tax reductions should be directed towards leaving more purchasing power in the hands of the public and so stimulating inadequate demand for goods and services, both locally produced and imported.

The Need for Public Understanding

935. Throughout the report we have emphasised the major role of budgetary policy which brings management of the economy directly into the sphere of politics. It follows that the final decision in major questions of economic policy rests with the people themselves.

936. If the community is to rely on the Government to guide the economy towards the objectives of stability, productivity, and security, it must be prepared to accept necessary measures which will, in the short run, adversely affect some individuals and interest groups.

937. A real difficulty in the way of adopting comprehensive budgetary and monetary policies designed to combat inflation is the problem of securing the necessary public support for such policies. In a depression there is not the same difficulty because such policies as cheap and plentiful money and Budget deficits operate to the immediate personal advantage of many members of the community. In wartime, too, support is usually forthcoming for drastic measures, when the people are under the impulse of patriotic motives.

938. The latest Economic Report of the President of the United States contains the following relevant passage:

> Governmental measures of monetary and fiscal restraint are not as readily accepted as are measures of economic stimulation. The manufacturer who sees an opportunity to expand his activities by borrowing cannot always understand why his bank is so short of funds that he must put up with a smaller loan than he requested. Nor can the homebuilder or merchant or consumer. Nor, for that matter, can the banker. To each participant in the economic process a shortage of credit may appear as a restriction on his own opportunities. But the basic shortage under conditions of high prosperity is on the side of physical resources, not on the side of money or credit. If credit on easy terms were available to everyone at a time when the economy is already working close to capacity, the consequence would be a scramble for limited resources and a cumulative bidding up of prices. If taxes were simultaneously reduced, this inflationary process would only be speeded up. A government that sought to prolong prosperity by such devices would be taking a road that all too often has ended in disaster.

939. When the electorate accepts anti-inflationary policies in the interests of internal stability and external solvency it is merely facing the facts. As the Economic Report quoted above says of the United States:

> . . . the degree to which people accepted and approved the programme of fiscal and monetary restraints as the better part of wisdom, testify to our increasing maturity as a nation in dealing with the problem of economic instability.

Financing of Government Capital Expenditure from Taxation

940. We believe that, under circumstances prevailing at present or likely in the foreseeable future in New Zealand, it will be necessary for Governments to use monetary and budgetary policies to deliberately influence the general level of demand. At present these policies should be directed towards checking the level of demand by limiting and at times reducing the total amount of purchasing power in the hands of the public. We do not regard the control of trading-bank advances and small increases in interest rates as adequate without strong support from the Budget.

941. Public understanding and acceptance of Government measures is more than ever necessary, because an increasing proportion of Government expenditure, including capital expenditure, is being financed from taxation. It is by this means that the Government can do most to offset the inflationary effects of capital expenditure. When the level of voluntary private savings is inadequate it is necessary for the Government to "save" by using taxation to finance capital expenditure.

942. The substantial amount of capital expenditure financed from taxation and other revenue is clear from an analysis of General Government Revenue and Expenditure published by the Department of Statistics. It shows the following balances of revenue over current expenditure compared with Central Government capital expenditure[1]:

Year Ended March	Central Government Capital Expenditure[1]	Excess of Revenue Over Current Expenditure
	£ million	£ million
1938–39	16	1·5
1949–50	39	9·0
1950–51	41	28·3
1951–52	41	43·5
1952–53	55	28·7
1953–54	57	30·7
1954–55	59	54·2

[1] This total excludes debt repayment, purchases of land, and a number of other items which are not "capital investment" in the economic sense.

Clear Presentation of the Budget and the Public Accounts

943. We consider that the position set out above should be made clear in the presentation of the Budget and in the Public Accounts as well as in the statements prepared by the Department of Statistics. This practice of financing capital works from taxation is beneficial to the whole economy and we think it should be fully explained and shown more clearly in the Public Accounts.

944. It is likely that the Government will find it necessary to finance an increasing proportion of its total expenditure from taxation.

945. An essential part of the explanation of monetary and budgetary policies is the publication of clear and comprehensive statements of the Government's own financial transactions. We realise that considerable progress has been made in recent years in presenting such information. We have noted particularly the statements contained in the Estimates of National Income and Expenditure prepared by the Department of Statistics and the summary of the Public Account which appears as Table 1 of the 1955 Budget and as Table 23 in the 1955 Economic Survey. We consider there is room for further improvement in the presentation of statements showing the effects and explaining the purpose of the Government's financial transactions.

Further Public Information Required

946. In our opinion a clearer statement of the Public Accounts will not in itself be enough to bring public understanding and stimulate public interest. Any such improvement should be supplemented by other means. To some extent this already is being done through Government publications which include the Economic Survey, an explanatory annual review of the economy presented by the Minister of Finance. These surveys are authoritative, clear, and informative, and, if widely circulated, should assist public understanding of New Zealand's problems and the measures being taken to meet them.

947. The Reserve Bank publishes a considerable amount of information about the working of the banking system and its relation to the whole economy. Its monthly bulletin, its annual report, and other publications all contain matter of real value. Some contribution is also made by the trading banks in the quarterly reviews published by two of the banks. However, though excellent in content and clear in exposition, the articles in these publications are often directed to a special audience and their distribution is limited.

948. The Commission is of opinion that much more than this could and should be done. As a matter of policy there should be a continued and systematic explanation of Government monetary and other economic policies and their purposes against the background of national circumstances.

Conclusion

949. The Government is entitled to the best possible assistance not merely in formulating its monetary, budgetary, and other economic policies, but also in placing these policies before the public in an objective manner. We believe that the Economic Advisory Council which we have suggested, could play an important part by submitting for the consideration of the Government and for the information of the public an annual report on the New Zealand economy, with recommendations as to the policies which should be adopted.

950. We also believe that a longer parliamentary term would enable the results of policy to become apparent, and to be understood in better perspective. With a longer term, Governments would have a better opportunity of initiating measures which might be temporarily unpalatable but which in the longer run would provide their own justification.

951. In the final analysis, we are convinced that, whatever machinery is set up to assist or advise the Government on financial and economic policy, the responsibility for policy decisions and for explaining them to the public rests with the Government itself.

Section Ten

SUMMARY OF MAIN FINDINGS AND CONCLUSIONS

(NOTE.—This section contains only a bare summary of the Commission's findings and conclusions. It should be read subject to the qualifications and additional details contained in the other paragraphs identified by the report paragraph numbers in brackets.)

Assessment of the Present Monetary, Banking, and Credit Systems in New Zealand

952. In assessing the present systems, it is necessary to recognise:

(a) That there is a limit to the amount which any country can produce or obtain by overseas trade for distribution among its citizens, and that this limit cannot be escaped by any manipulation of the monetary, banking, and credit systems. (Paragraphs 360 and 361.)

(b) Quite apart from the type of monetary, banking and credit systems adopted, New Zealand's economy is inevitably subject to disturbance from the effects of new inventions, changes in the patterns of spending and saving of the people, and economic fluctuations overseas. (Paragraph 367.)

953. The most that can be expected from the monetary, banking, and credit systems is that they should certainly not aggravate these natural instabilities; and that they should be capable of being used to assist in the economic adjustments which are necessary to enable society to reap the benefits, while countering any drawbacks of technical and economic changes. (Paragraph 368.)

954. The main criticisms of the present monetary, banking, and credit systems made before the Commission were:

(a) That they had held down the standard of living of the country, because they did not provide sufficient purchasing power for people to buy the goods and services which could be produced.

(b) That they had failed to provide the community with money which remained stable in purchasing power. (Paragraph 369.)

955. The Commission does not agree with the first of the above criticisms of the systems. (Paragraph 370.) **The second criticism is valid, but the problem is to find improvements which could be made in the existing systems or their operation, or to find alternative systems which would provide greater stability of prices without frustrating healthy economic development, full employment, and other desirable ends.** (Paragraph 371.)

956. None of the major proposals for reform of the existing systems put to the Commission seems to us to provide an acceptable solution to this problem of instability of prices. (Paragraph 372.)

957. In our view, no radical reform of the existing systems is necessary, although we consider that their administration could be considerably improved. (Paragraph 373.)

958. We do not believe that there was any practicable means of preventing the increase in overseas prices which has occurred since 1935 from generating a considerable increase in prices, incomes, and the volume of money in New Zealand. (See Section Five of this report.) (Paragraph 374.)

959. However, we believe that the authorities have permitted spending to expand unduly from time to time, with the result that there has been excessive competition for the limited supply of labour and resources available, a greater rise in costs and prices than was justified by external factors alone, and recurrent balance of payments difficulties despite large current earnings of overseas exchange and improved terms of trade. (Paragraph 375.)

960. A major factor contributing to the unduly high domestic spending was a large increase in the volume of money. In turn, one of the factors leading to this increase in the volume of money was an expansion of bank advances. This was not a particularly significant factor up till 1949; but advances were expanded excessively during the period from 1949 to 1952 and again in the period 1954–55. (Paragraph 376.)

961. The failure of monetary policy to prevent an undue expansion of advances in recent years has not been due primarily to weaknesses inherent in the reserve ratio system. The main reasons for failure have been:

(a) Tardiness in making use of the reserve ratios while direct controls were being relaxed a few years after the war.

(b) Reliance by the authorities:

(i) On voluntary co-operation from competitive trading banks which was not fully forthcoming; and

(ii) On the theory that leaving the banks with only a narrow margin of free cash would induce them to restrict lending.

(c) Insufficient speed and resolution in effectively applying the reserve ratio controls to changing conditions.

(d) Lack of co-ordination between policies designed to control bank advances on the one hand, and fiscal, capital issues, interest rate, and housing-finance policies on the other. (Paragraph 378.)

962. Quite apart from making the control of advances more effective, it is most desirable that, when reduction of spending is necessary to control inflationary pressure, it should be effected through a series of co-ordinated measures, covering a wide field of spending, rather than through additional restrictions in one field of activity alone. In the past two years, undue reliance has been placed on control of spending by the restriction of bank advances, with insufficient attention to supporting this control by other means. Should an expansion of spending prove desirable at some future period, it can be achieved most effectively by a variety of measures which ensure that the increase is spread over the community as a whole. (Paragraph 405.)

963. Greater attention should have been paid to stimulating voluntary savings, and greater use should have been made of higher interest rates

and a more restrictive budgetary and housing-finance policy as part of a co-ordinated policy to restrain spending. (Paragraph 419.)

964. No monetary, banking, and credit systems could create an economic Utopia or fully counter fluctuations which occur for reasons other than the operation of those systems. But we believe that, given wise, timely, and resolute action by the Government and its monetary authorities to counter inflationary and deflationary tendencies, the existing monetary, banking, and credit systems will continue to contribute to the healthy expansion of economic activity in New Zealand, while maintaining the maximum possible degree of freedom for its citizens. (Paragraph 420.)

Main Causes of Inflation in New Zealand

965. The main causes of inflation operating in New Zealand during the last twenty years emerge from the historical review contained in Section Three of this report, as:

(a) Rising overseas prices for New Zealand exports and imports.
(b) High private and Government capital expenditure.
(c) Government expenditure on war and other military requirements.
(d) Inadequacy of voluntary savings to match increased capital investment.
(e) Expansion of the money supply through increases in Reserve Bank and trading-bank advances.
(f) Wage and salary increases.
(g) The comparatively rapid population increase in the post-war years.
(h) Increased Government expenditure on social services and the philosophy and policies commonly associated with the Welfare State. (Paragraph 252.)

Should the State Have the Sole Right to Create or Destroy Money?

966. The Commission rejects the contention that the operations of the New Zealand trading banks under the existing banking system are illegal. (Paragraph 433.)

967. Insufficient or excessive credit creation can have important repercussions on the whole economy and, for that reason, control should be exercised by the Government through the Reserve Bank and, if necessary, through the Bank of New Zealand. Such control can be exercised under existing legislation. Furthermore, the Government has itself adequate powers to create money through the Reserve Bank or through its ownership of the Bank of New Zealand. (Paragraph 445.)

968. To concentrate the whole of the trading-bank activities or the whole business of credit creation in a Government monopoly of banking would, in the opinion of the Commission, lead to an undue and unnecessary aggregation of power in the hands of the Government. It would remove a highly desirable element of competition and it could not be expected to provide as good a banking service as the commercial community now enjoys. (Paragraph 446.)

Social Credit Submissions

969. The case prepared by the New Zealand Social Credit Association Incorporated for submission to the Commission did not conform with what many people have come to accept as Social Credit theory and policy. (Paragraph 449.)

970. After close examination of the Social Credit submissions and evidence the Commission finds that:

(a) The Social Credit Association witnesses and counsel were seriously at variance, not only with other social crediters who appeared before us, but also among themselves. They made significant withdrawals in matters of substance; even the A + B theorem was virtually discarded. (See paragraph 450.)

(b) The Association's witnesses presented a distorted picture of the present state of the New Zealand economy and their analysis of New Zealand's existing monetary system was falsely based and seriously erroneous.

(c) They failed completely to substantiate their original submission that there was a chronic gap between purchasing power and prices (that is, a chronic shortage of purchasing power), which is a fundamental proposition of Social Credit. They withdrew during the hearing from their chief arguments in support of this proposition.

(d) The only positive Social Credit proposal for immediate application sustained throughout the hearings by the Association was that a National Credit Authority should be set up and a national survey made to ascertain, *inter alia*, whether or not a gap existed.

(e) Nevertheless, their whole submission rested on the assumptions that the survey would undoubtedly disclose a gap and that an increase in the volume of money was of itself certain to bring increased production of goods and services.

(f) On the basis of these totally wrong assumptions, they envisaged the application to the existing inflationary situation of remedies devised for a situation of depression, like that of the 1930's on which their theory appears to be founded. They did not allow for the radical change in circumstances since then, and they drew many of their examples of alleged deficiences in the present economic system from the conditions of twenty-five years ago.

(g) There is abundant proof that New Zealand's present problem is not a shortage of purchasing power, as in the 1930's, but an excess of purchasing power. Nothing in the Social Credit proposals was designed to meet such a situation. When, as now, the resources of the community are already over-stretched, further issues of money will produce nothing except further pressure on the existing supply of goods and services—and consequent higher prices and dissipation of overseas exchange reserves.

(h) If made in the present circumstances, the large issues of debt-free money contemplated by the Association, and recommended by other Social Credit witnesses, would produce most serious and chronic inflation and gravely disrupt New Zealand's economy.

(i) The admitted ultimate objectives of Social Credit, the abolition of debt and interest and the substitution of a national dividend for the wage and salary system, would ultimately result in the abolition of private ownership of property. (Paragraph 502.)

Submission of Mr H. J. Kelliher and The Mirror Publishing Co. Ltd.

971. The Commission's conclusion on these submissions are summarised as follows:

(a) In his analysis of the economic system Mr Kelliher greatly exaggerates the effects of increases in the money supply and especially of trading-bank advances as causes of increases in the New Zealand price level.

(b) The claim that trading-bank lending and investment transactions under the Loanable Funds Scheme would not result in increases and decreases in the money supply or in the creation and destruction of money is not sustained. Neither is the related claim that under Mr Kelliher's scheme the trading banks would *"borrow to lend"*.

(c) Apart from certain open market operations, which we do not consider would be effective, there is no provision in the Loanable Funds Scheme by which an inflationary situation could be remedied *"without restricting bank lending for private and business purposes"*. If trading-bank lending was expanded as Mr Kelliher proposed *"to the limit of creditworthy borrowing"*, the result in present circumstances would be highly inflationary.

(d) Under the Loanable Funds Scheme, contraction of trading-bank credit in a recession would have the same effect on the money available for spending by the public as it would have under the existing system.

(e) The principal criterion for future increases in bank lending (i.e., increases in fixed deposits) is unsound in principle and, in our view, would be likely to prove far too rigid in practice to enable the trading banks to meet the needs of trade and industry in an expanding economy.

(f) The contention that the trading banks are operating illegally in conducting their lending and investment operations as they do is rejected.

(g) The Loanable Funds Scheme would not *"enable all controls to be dispensed with"*. Indeed adoption of the ancillary proposals put forward by Mr Kelliher would substitute a number of more rigid controls in place of certain existing controls.

(h) In our view, the ancillary schemes submitted by Mr Kelliher in support of his Loanable Funds Scheme contain many impracticable features and would have highly inequitable results, even if they could be operated. (Paragraph 545.)

972. In the light of the foregoing conclusions we are completely convinced that the Loanable Funds Scheme should not be adopted. Nor do we recommend adoption of the ancillary schemes for insulation of the New Zealand economy, for control of capital investment, and for regulation of wage increases. (Paragraph 546.)

(NOTE—See also paragraphs 433 and 966 regarding the legality of trading-bank operations in New Zealand, and paragraphs 600 and 975 regarding trading-bank profits.)

Proposals for a Commodity-backed Currency

973. **Adoption of these proposals is not recommended.** (Paragraph 549.)

The Trading-bank System

974. **The Commission's views on methods of controlling bank credit are:**

(a) In consultation with the trading banks the monetary authorities should try to assess the levels of bank credit which are likely to be in the best interests of the country in the months ahead, should inform the trading banks promptly and clearly of the credit policy decided upon, and should give them a direct financial incentive to co-operate in this policy.

(b) The policy should be as direct and simple in operation as possible and should be capable of prompt adjustment to meet changing circumstances. It should allow for competition among the banks for business. The public should be fully informed of the current policy and the means being used to carry it out.

(c) Several different methods of control could be used to implement these principles. (See paragraph 571.) **However, no reserve ratio system will automatically provide the banks with a financial incentive to co-operate with the policy of the authorities, who must be prepared to vary the minimum reserve requirements quickly and resolutely in order to make them effective.**

(d) No limit should be placed on the power of the authorities to raise these requirements to whatever level is deemed necessary in the public interest. But, if reserve requirements are fixed at very high levels, it might sometimes be equitable to allow the banks interest on part of the balances which they are required to keep at the Reserve Bank, or to permit them to take up Treasury bills held by the Reserve Bank.

(e) More use should be made of changes in bank overdraft interest rates as an aid to credit policy. The banks should be permitted to fix rates of interest on overdrafts within a fairly wide range on the understanding that the average rate of interest charged will be at a level deemed desirable by the authorities.

(f) The banks should be requested to use this right to fix overdraft rates within a wider range in such a way as to strengthen the selective advance control policy, which we recommend should be retained while inflationary circumstances prevail.

(g) If an effective system of control of total bank credit (advances, discounts, and investments) is adopted, the banks should be allowed to invest in Government securities.

(h) The operation of the reserve ratio system of control would be improved if:

(i) Notes and coin held by the banks were included together with the balances at the Reserve Bank, for the purpose of meeting the minimum reserve requirements.

(ii) Fluctuations in bankers' cash were reduced by the introduction of a system of pay-as-you-earn taxation and the staggering of payment of taxes by companies and farmers.

(iii) The trading banks were from time to time to examine existing overdraft limits critically with a view to eliminating unexercised limits considered unnecessary.

(i) Successful use of monetary policy requires considerable skill and judgment by the authorities. In a country like New Zealand, which is especially subject to disturbances arising from external trade as well as to those arising from technical change and changes in the mood of business and consumers, it is essential that policy should be flexible. Adjustments should be made promptly either to meet changing circumstances, or if the authorities find that they have previously made an incorrect diagnosis. A change of monetary policy is not a sign of weakness, but a sign of increased knowledge and alert appreciation of changing conditions. (Paragraph 597.)

975. After carefully examining the profits of the New Zealand trading banks as a group for each of the years 1943 to 1954 the Commission is satisfied that the profits were reasonable during this period. (Paragraph 600.)

976. Nevertheless, because of the apparent uneasiness of a considerable section of the public in regard to bank profits and because of the advisability of inducing the utmost public confidence in the administration of the trading-bank system, we recommend that the Government should take power forthwith to enable it to investigate the profits of the trading banks if at any time in the future such a course appears to be advisable in the public interest. (Paragraph 601.)

977. It is recommended that consideration be given to:

(a) Abolishing or reducing the inland exchange charge made for the collection of cheques.

(b) The fixing of the half-yearly charges for keeping customers' accounts in a manner more commensurate with the work involved. (Paragraph 608.)

978. Steps should be taken to transfer the accounts of marketing authorities (other than the Dairy Products Marketing Commission) to the trading banks. (Paragraph 611.)

979. There is no reason why statutory marketing organisations merely by virtue of the fact that their accounts are held at the Reserve Bank should receive preferential treatment over other marketing organisations with respect to interest charges. We therefore recommend that the rate of interest payable on an advance granted by the Reserve Bank to a statutory body should be similar to that which it would be required to pay if its finance were obtained from the trading banks. (Paragraph 612.)

Interest Rates

980. The past policy of cheap money is unfitted to the conditions obtaining in New Zealand today. (Paragraph 637.)

981. In our opinion a continuing policy of fixed low interest rates contributes to inflationary pressure. Under today's conditions such a policy tends both to discourage savings and to increase spending by facilitating borrowing. (Paragraph 638.)

982. An easing in the annual expenditure on building construction including dwellings is desirable, both from a short-term point of view and in the interest of the long-term stability of the building industry. We believe that a rise in interest rates would operate as a restraint on the present rate of building construction and that it should be used for this purpose. (Paragraph 640.)

983. In inflationary circumstances it is a mistake for the Government to endeavour to hold down rates of interest by refraining from borrowing to finance its own capital expenditure and meeting its requirements by drawing on accumulated cash balances or by increasing its borrowing from the banking system. Either course is directly inflationary. (Paragraph 642.)

984. An ultimate objective should be the complete freeing of interest rates from control so that supply and demand will bring about periodic variations best suited to the conditions from time to time obtaining. We realise, however, that a sudden complete removal of long-standing controls may have serious repercussions while inflationary circumstances persist. In the meantime, therefore, we recommend that progress be made towards the above ultimate objective by forthwith increasing in some degree the whole pattern of interest rates. (Paragraph 644.)

985. It appears to us essential that the maximum local authority borrowing rate should be revised from time to time so as to preserve an appropriate margin above the effective rate at which the Central Government can borrow on the market. (Paragraph 720.)

[Since the above was written maximum interest rates have been increased in a number of instances.]

Control of Borrowing by the Public

986. So long as it is necessary to retain the Capital Issues Committee, we consider that its decisions would be more widely acceptable if the personnel were changed by reducing the number of State servants on the Committee and correspondingly increasing the number of members selected or appointed from the business community. (Paragraph 647.)

987. The Commission makes the following recommendations in regard to matters which at present come within the purview of the Capital Issues Committee:

(a) That the limit of issues of capital which may be made without the consent of the Committee (now fixed at £10,000) should be raised appreciably. The present restrictions encourage complicated procedures in order to avoid the need for making application to the Committee.

(b) That the issue of preference shares should be freed from control, with the exception of:
(i) Redeemable preference shares.
(ii) Cases where the preference dividend is non-cumulative.

(c) That the fixing of the appropriate premium on an issue of shares should be left to the discretion of the directors of the Company concerned.

(d) That the Committee should not refuse permission to companies to issue capital on the grounds that the proceeds of the issue are to be used to reduce or repay bank overdrafts. Such a policy tends to increase the difficulties of controlling bank credit. It should be a condition of any consents granted under this recommendation that the proceeds of any such issues should be applied to the reduction or extinction of bank accommodation previously granted. (Paragraph 649.)

988. In New Zealand there are no satisfactory statistics available on any section of hire-purchase trading, and it is therefore impossible for the Commission to make any statement on the question as to whether hire-purchase trading is actually increasing in total or not. (In our recommendations regarding improved statistical information we recommend that statistics of hire-purchase trading be collected.) (Paragraph 652.)

The Stimulation of Private Savings

989. Trustee savings bank and Post Office Savings Bank interest rates should be increased as part of the general interest rate policy. (Paragraph 663.)

990. Consideration should be given to allowing savings-bank interest up to a fixed maximum to be excluded from returnable income for income-tax purposes. (Paragraphs 664 and 665.)

991. A proposal for guaranteeing the purchasing power of "small savings" is not recommended. (Paragraph 667.)

992. A scheme of premiums on savings is recommended for consideration by the Government. (Paragraph 670.)

993. The restrictive provisions in section 5 of the Trustee Savings Bank Act 1948 should be repealed and every possible encouragement should be given to the establishment of new trustee savings banks in the main centres and to the opening of branches in the smaller towns. (Paragraph 680.)

994. The Government should fully investigate the recent Australian legislation authorising trading banks to carry on savings-bank business. (Paragraph 686.)

995. It would be in the national interest if more facilities for investment on the stock exchange could be made available to the small investor. (Paragraph 692.)

Need for New Financial Institutions

996. Proposals for a Postal Clearing Service should be investigated by the appropriate departmental officers. (Paragraph 696.)

997. A short-term money market should be established in New Zealand. (Paragraph 703.)

998. A case for the immediate establishment of an Industrial Finance Corporation has not been substantiated, but such an organisation may prove desirable at some future time. (Paragraph 714.)

999. Establishment at this stage of a Government-sponsored Local Government Finance Corporation is not favoured by the Commission. (Paragraph 726.)

The Balance of Payments

1000. It is a matter for concern that our overseas exchange reserves have been drawn down to such a considerable extent in the past two years. (Paragraph 744.)

1001. A balance of payments deficit may be overcome in several ways, the main methods being to:

(a) **Increase the volume and quality of production and reduce costs in New Zealand.**

(b) **Restrain domestic expenditure on goods and services.**

(c) **Impose direct control over imports and exchange transactions.**

(d) **Raise the exchange rate.**

(e) **Raise tariffs against imported goods.**

(f) **Borrow overseas.**

(g) **Induce other countries to remove barriers to the sale of New Zealand's exports at more remunerative prices.** (Paragraph 748.)

1002. The major reason for the balance of payments deficits of 1951-52 and 1954-55 was that domestic spending expanded excessively in relation to the local goods and services which could be made available at current prices and the imported goods and services which could be provided out of the country's current overseas earnings. (Paragraph 750.)

1003. In other words, these balance of payments deficits were merely symptoms springing from a more fundamental cause, an attempt by the country to live beyond its means by consuming and investing more than it earned by its current output. The main lesson from the experience of this period is that, if we are to avoid a recurrence of these problems in the future, the Government must adopt timely and appropriate fiscal and monetary policies to prevent excessive demand from being generated. (Paragraph 751.)

1004. We do not believe that the experience of the last five years proves that to maintain a high level of prosperity and full employment it is necessary to retain direct controls over imports and exchange transactions permanently. (Paragraph 753.)

1005. It is recognised that there may well be occasions when it is essential in the national interest to impose direct controls. For example:

(a) **We believe that it is essential to maintain direct control over capital transfers overseas.**

(b) **Since direct controls can effect a reduction of imports more quickly than the other methods available, there would be no alternative but to use them if the reserves of exchange fell to a dangerously low level, while balance of payments deficits continued and it was impossible to borrow overseas.**

(c) There would be a strong case for their use if balance of payments deficits persisted after the level of demand had been reduced by fiscal and monetary measures to a point where any further reduction would cause serious unemployment in the country. (Paragraph 754.)

1006. The deficits of 1951–52 and 1954–55 occurred despite very high export prices and were accompanied by inflationary conditions internally. An attempt to meet the situation by import or exchange controls alone would not have dealt with the root cause of the problem – indeed, by preventing the high level of internal demand from being directed partly to imports, the controls would merely have aggravated internal inflation. (Paragraph 755.)

1007. Frequent variation of exchange rates (whether automatically or by Government action) as a method of controlling the balance of payments is not recommended. (Paragraph 771.)

1008. If balance of payments difficulties are due to internal inflation, the best way to get rid of them is to take steps to cure the inflation. If the difficulties are not due to internal inflation, and no outside assistance is available, the Government must choose from among import and exchange controls, higher tariffs, devaluation of the currency, or other measures designed to reduce spending as a means of correcting the position. (Paragraph 775.)

Protecting the Economy from Effects of Price Changes Overseas

1009. There are four main sets of measures available for use by Governments to counter the effects of price changes overseas. They are:

(a) Automatic variation of the rate of exchange.
(b) Occasional variation of the rate of exchange.
(c) Guaranteed price, floor price, or proceeds retention schemes.
(d) Monetary and fiscal policies. (Paragraph 777.)

1010. In the opinion of the Commission, no case has been made for changing present practice in regard to exchange rates. We consider that, as a general rule, the exchange rate should be kept stable, adjustments being made only to meet special circumstances. (Paragraph 782.)

1011. The Commission does not view with favour any guaranteed price basis for farm products where the chief criterion of price is average cost of production and a "reasonable" standard of living for the producer; and where there is little or no regard to export prices. (Paragraph 784.)

1012. There appears to be more flexibility and merit in an equalisation or support price scheme which will counteract sharp rises or falls in prices, and as far as practicable level out extreme fluctuations in farming returns. (Paragraph 786.)

1013. In the event of any sudden and steep rise in prices in any item of exports, which might be expected not to last long, consideration should also be given to freezing a portion of the increase and releasing the amount so withheld over a period of years as was done in the case of wool in and after 1950. (Paragraph 789.)

1014. It is important that any amounts withheld from farmers under equalisation and support schemes should not be allowed to form the base of any expansion of credit and that additions should be made to our overseas reserves sufficient to provide for the demand for imports which must arise when releases are made. (Paragraph 790.)

1015. If, when overseas prices change, it is impracticable to counter the effects of the changes by varying the exchange rate, the changes in overseas prices must be reflected to some extent in the New Zealand economy. For example, it would have been quite impracticable to have prevented, by domestic policies, a substantial rise in the New Zealand price level as a result of the general but uneven rise in external prices which followed the outbreak of war in Korea. The objective of policies (fiscal, monetary, and stabilisation of farm incomes) in such circumstances, therefore, cannot be to prevent a rise in prices, but to ensure that spending in New Zealand does not expand excessively, and lead to a spiral of costs and prices out of line with overseas trends, to large numbers of employment vacancies, and to eventual balance of payments difficulties. (Paragraph 792.)

Dealing with a Recession in Export Prices

1016. Steps appropriate to deal with a fall in export prices, expected to be temporary, would consist of measures to keep up the flow of imported goods and of measures to maintain spending in New Zealand. (Paragraph 793.)

1017. The key to an effective full-employment policy in New Zealand lies in maintaining adequate reserves of foreign exchange in times of prosperity, for employment and living standards can be maintained in the face of falling export receipts only if we can maintain an adequate flow of imports. Unless we could borrow overseas, we could maintain imports in the face of a fall in export prices or a deterioration of our terms of trade only by drawing on exchange reserves. (Paragraph 794.)

1018. Although it is not necessary that the New Zealand economy should follow every fluctuation of economic activity in its major markets overseas, it is impossible to protect ourselves completely from such fluctuations. There is no simple formula or automatic device which will provide a satisfactory solution to the problems which arise from changes in overseas prices. (Paragraph 797.)

Overseas Borrowing

1019. Undue reliance should not be placed on overseas borrowing as a means of achieving stability, both internally and in the balance of payments, at the present time, when export prices are high and our difficulties are principally due to internal inflationary pressure. The main attack on these problems must come from domestic monetary and fiscal policies, although overseas borrowing, in strictly limited amounts, may be useful as a supplement to appropriate domestic policies. (Paragraph 808.)

1020. New Zealand could quite properly borrow in the dollar area in conformity with general sterling area policy. (Paragraph 810.)

1021. New Zealand's external financial position would be strengthened to some extent if an arrangement could be made with the United Kingdom Government to extend short-term credits to New Zealand, if required, at a time of general recession. (Paragraph 811.)

New Zealand Membership of the International Monetary Fund and the International Bank

1022. It appears to the Commission that a country heavily dependent on world trade like New Zealand has a great deal to gain from any agreements which go some way to achieving the objectives of the International Monetary Fund and Bank. The history of the inter-war years demonstrated conclusively the folly of each nation's attempting to solve its trade and employment problems by measures which inevitably destroy the prosperity of others, and the desirability of international co-operation in the fields of trade and finance. (Paragraph 820.)

1023. The contention that a loss of sovereignty is involved is not a soundly-based argument against joining the Fund and Bank. (Paragraph 831.)

1024. No evidence was brought before the Commission to support the allegation that the Fund or Bank were in any way dominated or controlled by "Wall Street" or by any conspiracy of internatinal financiers, either independently or in association with communists. (Paragraph 833.)

1025. A number of other arguments for and against New Zealand membership of the Fund and Bank were considered. (Paragraphs 835 to 843.) **The conclusion is reached that the arguments in favour of joining the International Monetary Fund and International Bank for Reconstruction and Development heavily outweigh the objections to that course, and accordingly the Commission recommends that New Zealand should seek membership of these two world organisations.** (Paragraph 851.)

Better Information as a Basis of Policy

1026. After considering a number of suggestions the Commission is satisfied as to the need for additional information and recommends an extended programme of statistical collection. (Paragraph 854.)

1027. Amendments should be made to the monthly statutory return which the trading banks are required to make to the Reserve Bank. (Paragraphs 857 and 858.)

1028. A scheme requiring importers to notify their own trading banks before placing or confirming overseas orders is suggested for consideration. (Paragraph 870.)

1029. Consideration should be given to including unexercised overdraft authorities in statistics of the volume of money. (Paragraph 153.)

1030. Steps should be taken to establish an Economic Research Institute. (Paragraph 882.)

Co-ordination of Monetary Policy with Budgetary and Other Economic Policies

1031. The Reserve Bank of New Zealand Act should be revised to make clear and explicit the respective functions of the Government and of the bank in relation to monetary policy. In our view the Government must accept full and final responsibility for all decisions of policy in this field. We consider, therefore, that there should be no provision requiring a resolution of the House of Representatives to enable the Government to give directions to the Reserve Bank. In our view any such provision

merely detracts in the public mind from the full and final responsibility of the Government in matters of monetary policy. (Paragraph 897.)

1032. The Commission recommends legislation to make it clear and explicit that:

(a) It is the function of the Reserve Bank to give effect to the monetary policy of the Government as communicated to it by the Minister of Finance.

(b) The bank is to advise the Government on matters relating to monetary policy, banking, and foreign exchange.

(c) The bank is to keep the Government fully informed about the measures it is adopting or proposes to adopt to give effect to the monetary policy of the Government.

(d) If there is any difference of opinion between the bank and the Government as to the measures adopted or proposed to be adopted under (c) above, the bank is to give effect to a decision of the Government conveyed to it in writing by the Minister of Finance.

(e) The Government is to decide such important questions as exchange-rate policy.

(f) The Government is to have the power to initiate and direct a change in the reserve ratio. (Paragraph 898.)

1033. In respect of reserves of overseas funds, section 17 (1) of the 1933 Act, as substituted by section 4 (1) of the amendment Act of 1950, provides that "it shall be the duty of the Bank to maintain reserves which, in the opinion of the Board of Directors, will provide a reasonable margin for contingencies, after taking into account prospective receipts and disbursements of overseas funds, and having regard to the economic position within New Zealand". In the opinion of the Commission this is not a responsibility which should properly be imposed upon the Reserve Bank when so many of the policy decisions which affect the state of our reserves of overseas exchange are made not by the bank but by the Government. (Paragraph 900.)

1034. The Government's power to control overseas exchange transactions should have the direct authority of statute rather than the mere authority of regulation. (Finance Emergency Regulations.) (Paragraph 902.)

1035. The Commission considers that the Government must retain the right of final decision upon questions of monetary policy and the right to detail the measures adopted to give effect to such decisions. (Paragraph 905.)

1036. An Economic Advisory Council should be established. (Paragraph 917.)

The Need for Comprehensive Monetary and Budgetary Policies

1037. Under modern conditions neither monetary policy nor budgetary policy is by itself an adequate means of discharging the very wide tasks which face the modern State, including the maintenance of full employment, stabilising prices, and controlling the demand for imports. (Paragraph 930.)

1038. To a very large extent the Government must pursue its broad objectives by influencing the general level of demand in the community. (Paragraph 934.)

The Need for Public Understanding

1039. Throughout the report, we have emphasised the major role of budgetary policy which brings management of the economy directly into the sphere of politics. It follows that the final decision in major questions of economic policy rests with the people themselves. (Paragraph 935.)

1040. If the community is to rely on the Government to guide the economy towards the objectives of stability, productivity, and security, it must be prepared to accept necessary measures, which will, in the short run, adversely affect some individuals and interest groups. (Paragraph 936.)

1041. A real difficulty in the way of adopting comprehensive budgetary and monetary policies to restrain inflationary pressures is the problem of securing the necessary public support for such policies. In a depression there is not the same difficulty because such policies as cheap and plentiful money and Budget deficits operate to the immediate personal advantage of many members of the community. In wartime, too, support is usually forthcoming for drastic measures, when the people are under the impulse of patriotic motives. (Paragraph 937.)

1042. The Commission considers that the Government will find it necessary to finance, from taxation, an increasing proportion of its expenditure, including capital expenditure, and we think that this should be clearly explained to the public in the Budget and in other reviews of the public finances. (Paragraph 944.)

1043. We consider there is room for further improvement in the presentation of statements showing the effects and explaining the purposes of Government financial transactions. (Paragraph 945.)

1044. There should be a continuous and systematic explanation of Government monetary and other economic policies and their purposes against the background of national circumstances. (Paragraph 948.)

1045. Whatever machinery is set up to assist or advise the Government on questions of financial and economic policy, the responsibility for policy decisions and for explaining them to the public rests with the Government itself. (Paragraph 951.)

Conclusion

1046. The foregoing summarises the conclusions and recommendations of the Commission, arrived at after a close examination of the New Zealand monetary, banking, and credit systems.

1047. In presenting this report the Commission acknowledges the most valuable assistance it has received not only from the evidence of those who were invited to explain the existing systems, but also from the submissions of those who advocated changes or alternatives.

1048. The Commission trusts that this report will serve to bring about a better and wider understanding of the monetary, banking, and credit systems, and that it will be of assistance to those charged with the heavy responsibility of promoting the "economic, financial, and social welfare of the people of New Zealand".

APPENDICES

Appendix A

WITNESSES WHO APPEARED AT THE PUBLIC HEARINGS AT THE DIRECT REQUEST OF THE COMMISSION

	Organisation Represented
Mr B. C. Ashwin	The Treasury.
Mr Colin Clark	......
Mr E. C. Fussell	Reserve Bank of New Zealand.
Mr F. H. Mullins	New Zealand Stock and Station Agents Association.
Mr E. C. W. Nathan	Stock Exchange Association of New Zealand.
Mr L. G. Oxby	Life Offices Association.
Mr J. M. Peterson	Dunedin Savings Bank.
Mr P. L. Porter	Capital Issues Committee.
Mr T. N. Smallwood	State Advances Corporation of New Zealand.
Mr F. E. Sutherland	Associated Savings Banks of New Zealand.
Mr A. B. Taylor	Local Government Loans Board.
Mr H. W. Whyte	Associated Banks in New Zealand.
Mr G. E. F. Wood	Department of Statistics.

WITNESSES WHO APPEARED AT THE PUBLIC HEARINGS AT THEIR OWN REQUEST TO PRESENT THEIR VIEWS OR THOSE OF SOME ORGANISATION OR OTHER PERSON

	Organisation or Person Represented
Mr L. Adams, Auckland	......
Mr A. E. Aiken, Waverley	......
Mr F. Allen, Auckland	......
Mr W. Appelbe, Raglan	......
Mr G. Aubury, Torbay	......
Mr B. Beckerleg, Auckland	Dominion Empire and World Federation.
Mr J. Begg, Dunedin	......
Mr R. W. Bolton, Tauranga	......
Mr E. W. Boulton, Auckland	......
Mr W. B. Bray, Auckland	......
Mr D. Brophy, Auckland	......
Mr J. R. Burfitt, Auckland	......
Mr L. Butler, Inglewood	......
Mr W. S. Cederholm, Wellington	......
Mr C. W. Clift, Hastings	British Israel World Federation (N.Z.) Incorporated.

	Organisation or Person Represented
Mr P. Cropper, Auckland	......
Mr R. E. Dawson, Wellington	Harbours Association of New Zealand.
Mr S. Dellabarca, Eastbourne	......
Mr G. W. Dodds, Wellington	Board of Promoters of an organisation to be called New Zealand Incorporated.
Mr A. K. Dyne, Christchurch	......
Dr J. C. Finlay, Auckland	......
Mr T. N. Gibbs, Wellington	Ex-shareholders Committee of the Bank of New Zealand.
Mr O. G. Hansen, Orini	......
Mr J. Hogan, Wellington	......
Mr W. J. Hyde, Wellington	......
Mr D. J. Janus, Palmerston North	......
Miss M. H. M. King, Dunedin Mr R. G. Young, Hamilton	New Zealand Social Credit Association Incorporated
Mr A. Leigh Hunt, Wellington	Dominion Settlement and Population Association Incorporated.
Mr G. E. Littlejohn, Wellington	......
Mr J. F. Lockington, Christchurch	......
Mr A. F. Long, Auckland	......
Dr R. G. McElroy, Auckland	......
Mr W. P. MacDougall, Hamilton	......
Mr M. G. Mackay, Days Bay	......
Mr G. L. Marshall, Marton	......
Mr G. V. Mullenger, Auckland	......
Mr W. S. Otto, Auckland	Mr H. J. Kelliher and The Mirror Publishing Co. Ltd.
Sister C. Peters, Wellington	......
Mr A. V. Pettman, Auckland	......
Mr H. L. Pickering, Scargill	......
Mr A. G. Potter, Waiuku	......
Mr M. G. T. Priest, Thames	......
Mr W. Robinson, New Plymouth	......
Mr A. G. Sainsbury, Auckland	......
Mr B. A. K. Savage, Wellington	Wellington Trust, Loan, and Investment Co. Ltd., the Equitable Building and Investment Co. Ltd., and the Wellington Investment, Trustee, and Agency Co. of New Zealand Ltd.
Mr D. Seymour, Hamilton	New Zealand Society for Economic Individualism.
Mr J. T. Shaw, Invercargill	Invercargill Savings Bank.
Mr T. F. Simpson, Lower Hutt	......
Mr H. Stewart, Auckland	......
Mr N. B. Stocks, Christchurch	......
Mr R. E. Taylor, Auckland	......
Mr W. H. Thompson, Hamilton	......
Mr P. E. Tingey, Wellington	......
Mr J. Turnbull, Wellington	New Zealand Public Service Association Incorporated

Name	Organisation or Person Represented
Mr F. P. Walsh, Wellington	New Zealand Federation of Labour.
Mr W. Weld, Christchurch	......
Mr L. K. Wilson, Piopio	......
Mr N. M. Wordsworth, Te Kopuru	......

COUNSEL WHO APPEARED AT THE PUBLIC HEARINGS, AND THE PERSON OR ORGANISATIONS THAT THEY REPRESENTED

Counsel	Organisation or Person Represented
Sir Wilfrid Sim, Q.C.	Associated Banks in New Zealand.
Dr O. C. Mazengarb, Q.C.	Mr H. J. Kelliher and The Mirror Publishing Co. Ltd.
Mr F. B. Anyon	British Israel World Federation (N.Z.) Incorporated.
Mr W. L. Ellingham	Wellington Trust, Loan, and Investment Co. Ltd., the Equitable Building and Investment Co. Ltd., and the Wellington Investment, Trustee, and Agency Co. of New Zealand Ltd.
Mr F. C. Jordan	New Zealand Social Credit Association Incorporated.
Mr D. R. Hoggard	Bank of New Zealand.
Mr S. M. Macalister	Invercargill Savings Bank.

Appendix B

PERSONS OR ORGANISATIONS WHO MADE WRITTEN SUBMISSIONS TO THE COMMISSION

Name	Major Submissions
Mr S. J. Attenborrow, Mangonui	The Government should create its own credit and not borrow from the trading banks.
Mr H. F. Bateman, Hastings	Abolish half-pennies and substitute penny half-penny coins; banks to pay interest on current account deposits.
Mr L. Brittain, Oratia	Internal currency should be completely independent of overseas currency; all currency to be free from political control.
Mr E. M. Broadbent, Tolaga Bay	Money is defined as a debt, ultimately recoverable from the assets of the debtor; coin is the only possible debt-free money.
Mr E. A. Brown, Tikipunga	An Upper House should be re-established in Parliament, consisting of two or three Godly Jews and the remainder Godly Christian Gentlemen to deal with finance; the United States and the Commonwealth should be closer together spiritually.
Mr N. S. Brown, Pleasant Point	Average tax assessment to be fixed for each trader; profit above this to be taxed at a decreasing rate.
Mr A. J. Butterfield, Hawea Flat	The whole banking system should be run by the State; honest international trading is essential.
Mr M. E. Constanticatos, Athens, Greece	The gold standard is a *"straight jacket"* under which the central bank and the trading banks pursue divergent policies; credit substitutes cannot fill a gap arising from deficient gold production; the *"fantastic and arrogant endeavour to subject the wealth value of gold to conscious management"* in the late twenties and early thirties led to world-wide economic nationalism.
Mr G. S. Crimp, Wellington	Local Body Corporation, Industrial Finance Corporation, and Mortgage Corporation to be established; present Government loans have drawbacks as gilt-edged securities; field of approved trustee securities needs widening.
Mr A. A. Currie, Wellington	Independent Social Credit submission; abolish taxation and create credit for Government annual outlay; obtain development moneys by loans from the public.

Name	Major Submissions
Mr K. T. Cusack, Oamaru	Gold mining should be encouraged to improve overseas currency earnings; progress payments to prospectors and subsidy on gold produced.
Mr K. W. Dalrymple, Bulls	To simplify farming income returns, the end of the taxation year for farmers should be changed from 31 March to 31 July.
Mr F. Dawson, Angaston, Australia	Issue of a national dividend direct to consumers; price control would be necessary; restraints on use of manpower should be removed.
Mr L. G. de Garis and Dr M. C. de Garis, Geelong, Victoria, Australia	The unit of money to be based on the unit of labour; money then will be accessible to all workers as a credit, not a debt; reconsideration necessary of the effects of "Double Account" book-keeping.
Mr W. Delaney, Runanga	All countries should adopt a universal guaranteed standard of currency; new money should be issued for development works and cancelled later if inflation exists; the State should press ahead with Crown land development.
Mr J. H. de Marr, Auckland	The money system should be based on the security of real property; a Money Board should be established in each main city in New Zealand; interest on the mortgage bank notes would be the main source of future Government and local body income; the banks and lending institutions would relend this money as they do now; transport should be financed by an annual tax on every dwelling and a sales tax on property as well as by fares.
Mr L. Duggan, Auckland	A limited inquiry into monetary affairs cannot produce anything beneficial; an open public Commission of Inquiry is necessary to establish a new moral order of civilisation.
Mr J. S. Eliott, Middlemarch	A commodity-standard currency is recommended, the unit being fixed on an index figure representing the export value of meat, wool, butter, and cheese; decimal coinage; variable exchange rate to keep the return to the producers steady; an Exchange Commission to fix the rate from time to time.
Mr R. Ewing, Canterbury, Victoria, Australia	Abolish private ownership; guarantee the right to an individual to occupy a home and to obtain basic necessities; operate all activities without finance and financial profit; issue a basic weekly amount to all consumers, and a second form of purchasing power to active workers for goods other than necessities; cancel all purchasing power when used for goods or services.

Name	Major Submissions
Mr C. Farmer, East Bridgford, Notts., England	Establishment of a State-held commodity reserve to support and stabilise the value of a currency.
Federated Farmers of N.Z. (Inc.), Wellington	Government to curtail its spending; a new note issue is required; foster competition; protect essential local industries by tariffs; abolish import and exchange control; after all these have been done, free the exchange rate.
Mr A. N. Field, Nelson	The New Zealand money system should be related as closely as possible to the national production of real wealth; a commodity unit based on butter, meat, cheese, and wool should be established; internal bills of exchange should be included in Reserve Bank's reserve against note issue; 100 per cent reserve against bank advances; no surrender of sovereign control over money system.
Financial Publications Ltd., Wellington	Copy of an article on *Financing Local Bodies,* by E. F. W. Sumner, forwarded; this article suggests that the establishment of a Local Authorities Finance Corporation has considerable potentiality; other major recommendations made concern interest rates, income-tax concessions, Government guarantees, and overseas borrowing.
Mr A. C. Foddy, Taupo	Special assistance to the aged, including cheap money for the building of homes.
Mr D. Gilberd, Whangarei	Interest rates should be linked to cost of living; restrictions on farmers should be removed; wage payments should be based partly on hours, partly on results.
Mr A. E. Grassby, Winnipeg, Canada	Amortisation periods are frustratively below depreciation and dividend limits; the greatest evils are inadequate capital investment, inadequate amortisation of such investments, inadequate national debt, and the use of confiscatory taxation instead of voluntary and compulsory savings.
Mr D. P. Green, Auckland	Sufficient single immigrants should be brought into New Zealand to fill the thousands of vacant jobs; married immigrants only complicate the present problem.
Mr K. Grieve, Auckland	Reserve Bank to be the sole source of credit; the trading banks to lend only their cash in hand or by borrowing from the Reserve Bank; Reserve Bank credit to be directly available for Government and local body works and for housing.

Name	Major Submissions
Mr J. C. Guillet, Bradford, Yorkshire, England	Treasury to have the right to create interest-free money for Government and local body expenditure, but recover this in taxation at the end of each year; later, this scheme might be extended to agriculture, housing, and industry.
Sir James Gunson, Auckland	Abandon controls and import licensing; abolish the Capital Issues Committee and the Reserve Bank; free rates of interest; revise the Customs Tariff to protect and stimulate all essential economic useful secondary industries and to provide revenue without undue restriction.
Mr E. T. Hensman, Wellington	Mutual respect between labour and management is necessary. There should be more saving; in times of prosperity unnecessary expansion of capital expenditure should be controlled; deferred projects or direct credit issues could be used in less properous times.
Mr H. S. Herbert, Morrinsville	Interest should be abolished.
Mr M. Hewitt, Cambridge	Stability of the internal economy is important; the exchange rate should be free to find its own level; a Rural Bank or Rural Credit Union is suggested to finance farm development; financial policy should be subject to Government control at national level, but scope is necessary for mutual or private enterprise at lower levels.
Mr G. F. Holibar, Titirangi	Credits from the Reserve Bank and Bank of New Zealand for national and local body works to be available on an interest-free basis apart from actual cost incurred; a unit of financial wealth to be created for every additional unit of real wealth coming into existence.
Mr F. Holloway, Christchurch	New Zealand should have a currency pound of its own; the recent five-shilling pieces were issued in an illegal manner; *"credit pounds"* should be used to finance public utilities.
Mr F. E. Hooke, Kawau Island	The Commission should make a clear statement on bank lending and deposit creation; idle deposits at trading banks should be used interest free for Government works; did the wool freeze prevent inflation?; radio advertising cost should not be deductible; motor imports should be kept down.
Mr K. F. Hopper, Whangaparaoa	Raise interest rates; borrow £500 million from Britain for farm development. The Reserve Bank is preventing the trading banks from financing desirable farm developments.

Name	Major Submissions
Mr H. A. Hosking, Rotorua	Demonstrations of Social Credit principles forwarded.
Mr J. F. Johnson, Whangarei	Hospital Board loan finance for the next three to five years to be provided by a special Government loan; failing this the Hospital Boards' Association to set up a loans committee to put the suggestion into effect.
Mr N. Kelly, Tokomaru	Usury should be forbidden; the charging of interest abolished.
Mr B. H. Kingston, Auckland	A standard of value to be fixed as equal to one hour of unskilled labour; external exchange rates to be fixed in relation to wage rates in other countries; this system to be extended throughout the British Commonwealth.
Mr W. S. Lang, Auckland	An inconvertible paper currency method designed to stabilise the value of money is suggested to meet the problem of regulating labour and money within a proper background of law and order and of culture.
Mr W. Leach, Thames	Nationalise the banking system over the next three years; a limit of 4½ per cent on farm and other mortgages; all Government borrowing apart from Post Office Savings Bank to be from the Reserve Bank.
Mr J. Long, Dunedin	The Reserve Bank should have the sole prerogative of issuing currency; no interest should be charged on redeemable Reserve Bank advances to State and local authorities; Reserve Bank should not be subservient to Government.
Mr R. L. McEwen, Palmerston North	The charges made by the trading banks for the various services performed should be more closely related to the costs of the actual service given to each client; abolish inland exchange charge.
Dr R. McNair-Wilson, Sway, Hampshire, England	The amount of money in circulation should be, at all times, enough to prevent it acquiring any scarcity value of its own; the British Commonwealth should work together to promote the maximum exchange of goods and services.
Mr R. C. Macfarlane, Napier	Debt-free finance – *"Service Credit"* – to be used for Government and local body works and for repayment of Government debt.
Mr J. W. Marshall, Palmerston North	Financial speculators use the credit of the community to exploit the public.
Meat and Wool Ltd., Wellington	Copies of two leading articles supplied – one comments on Kelliher booklet *Why Your £ Buys Less and Less*; the other points to the low financial return received by many farmers for extra work they may put in.

Name	Major Submissions
Mr W. T. Metcalfe, Onewhero	The causes of inflation are social security payments, monopolies, shortage of manpower, enormous company profits, advertising, low rates of interest, and sheltered industries.
Mr O. Metzger, Nelson	Refers to an article by Philip Pye, M.A., on Gesell's *Free Economy*. Would abolish interest by making the use of money as a means of saving impossible; this *"Free-Money"* would depreciate at a fixed rate, say, 5 per cent per annum.
Mr A. W. Moore, Frankton Junction	A special farm finance department to be set up in the Bank of New Zealand; this would not be subject to the credit restrictions imposed from time to time on a national basis; or extended operations of the State Advances Corporation to provide all farm finance on a more liberal scale.
Mr S. J. Moore, Nelson	Points out the depreciation in the value of an insurance policy taken out in 1919.
Mr W. T. Morpeth, New Plymouth	New Zealand pound to be at a premium with sterling; exchange alteration to be carried out as a normal function of financial policy.
Mr R. A. Morrison, Dunedin	The true facts relating to the establishment of the Reserve Bank should be published to preserve its integrity.
Mr C. M. Moss, Takapau	Remove all controls that restrict the free importation of goods and materials; declare that the Reserve Bank note is legal tender to any amount; Reserve Bank to declare a buying and selling rate for gold.
Mr H. S. Newbury, Norfolk Island	All money should be interest free at its source; it should also be debt free at its source to repay the Government and local body debts and to finance consumer credits.
Mr E. I. Nilsson, Kaitaia	Non-productive works should be financed from current revenue, not by borrowing; industries should be less highly protected; New Zealand must populate or perish.
Northland Hospital Board, Whangarei	A Local Bodies Loan Corporation, free from political control, to be established; money to be raised from the public by £5 bearer bonds and annual issue of debentures or stock; Corporation to have power to accept sinking funds and reserves for investment.
N.Z. Financial Times Co. Ltd., Wellington	Forwarded copies of articles by Dr R. G. McElroy. (Dr McElroy later appeared at the public hearings of the Commission.)

Name	Major Submissions
Mr K. O'Brien, Hastings	All future production to be financed by 100 per cent advance from the banks; depreciation on capital assets at fixed rates to be paid to the banks and cancelled; no controls over prices or profits.
Mr J. C. Parcell, Cromwell	Reserve Bank interest-free credits for Government and local body capital purposes, repayable by an annual sinking fund; similar interest-free finance for housing and farming; an Empire Exchange Pool to facilitate Commonwealth trade.
Mr I. V. Payne, Auckland	Non-revenue-producing projects should be financed by rates or taxes; revenue-producing projects should be financed from a common pool guaranteed by the common wealth.
The Peacemaker Foundation, Palmerston North	Suggested that this Commission should make an interim report; that a committee of experts should be appointed to examine monetary theory in the light of the potential of the radiation age; that the committee's report be published and the public hearings reopened in twelve months time.
Mr A. C. Pegler, Rotorua	Payout to meat producers to be reduced in buoyant times; reduce legal barriers imposed by lending institutions on house-building loans.
Mr A. R. Perry, Lower Hutt	Biblical and other quotations directed against usury or interest on loans and supporting Social Credit principles.
Mr C. E. Phillips, Auckland	A comprehensive submission covering the establishment of a company called New Zealand Ltd. to control the nation's assets and to distribute the national income.
Mr J. Price, Auckland	Comprehensive submission covering twenty-six lines of suggested action dealing with many phases of monetary system.
Mr K. Redmond, Wellington	Interest on Government loans to be adjusted from time to time to correspond with current market rate.
Mr S. Riddle, Kerikeri	The State, through a non-political authority, to have the sole right to create money.
Mr J. A. Ritchie, Auckland	The trading banks should be restrained from making large profits by using the peoples' credit.
Mr H. J. Robinson, Hamilton	All wages paid to be at award rates of pay and at ordinary time rates.

Name	Major Submissions
Dr W. P. Roelofs, Soest, Netherlands	Full employment is based on adequate and effective demand which, in a money economy, is determined by monetary-financial factors; preceded by the socialisation of land ownership, a combination of a tax on money (Gesell), State grants to the public, and State borrowing from the public at adequate interest to grant it to the public again, is suggested to maintain a stable general price level and to lead to a rate of interest equal to zero.
Mr T. Shaw, Westport	The *man-hour* to be used as a standard of value; Government works to be used to provide employment when necessary.
Mr J. J. Smith, Hawera	No more borrowing from overseas; no restriction on credit; reduce interest rates for house building.
The Social Sciences Movement of Australia, Kew, Victoria, Australia	Governmental action to establish open markets; control the general price level by controlling note issue; and adopt businesslike taxation.
Mr B. E. S. Tait, Dunedin	All emergency and abnormal expenses such as arise in wartime to be paid by a special issue of State-guaranteed money redeemable over twenty years by a 5 per cent taxation levy; the Christian principles of preventing usury and fostering goodwill and commonsense to be followed.
Mr G. K. Tavender, Black Hill, South Australia	There is a persistent shortage of purchasing power which can be bridged by the issue of debt-free money by the Reserve Bank to the Government for its expenditure and for the stabilisation of prices.
United Dominions Corporation (South Pacific) Ltd., Wellington	Pointing out that the company was engaged in industrial finance in New Zealand; that further financial assistance without inflationary consequences could be given if certain conditions were met.
Mr J. E. Van Panhuys, Havelock North	A postal current account system similar to that in the Netherlands should be established in New Zealand.
Sir Alliott Verdon-Roe, Hampshire, England	Debt money is the root cause of inflation, heavy taxation, strife, and war; the general level of prices will determine how much new debt-free money can be issued from time to time; Postal money should replace cheques and reduce taxation.
Mr E. C. Wadsworth, Takaka	Governments have made too large a proportion of the people dependent on the State; there is too much money in the hands of young people; our natural resources are being depleted beyond reason.

Name	Major Submissions
Mr W. H. Wakinshaw, Surbiton, Surrey, England	*"Consumer money"* is suggested to divert the increase in production to its rightful owners in the individual and the community; a comprehensive economic and monetary policy for New Zealand is outlined.
Wanganui Electors' Association, Wanganui	Arbitration Court, with expert assistance, to draw up national balance sheet to show any shortage in peoples' purchasing power; Reserve Bank to issue debt-free money to make up any ascertained shortage.
Mr I. W. Weston, Christchurch	Supports the principle of an international commodity currency to facilitate world trade and stability of international markets.
Mr P. Williams, Timaru	The economic advantage of teaching Esperanto to New Zealand youth.
Mr C. F. Woods, Nelson	The need for the issue of new debt-free money is indicated by the wages lost from unemployment; debt-free money should be issued for both capital expenditure and wages (including relief).
Dr F. P. Worley, Taupaki	It is the rapidity of the present changes and not their nature or direction which is the chief cause of present trouble; depreciation in the value of money as a consequence of past happenings is inevitable; manipulation of currency to increase inflation or long-term fixing or control of major components of the system should be resisted; the elements of instability in our capitalistic system constitute its source of power; the trading banks must be strong but must not misuse their power.

Appendix C

THE DEFINITION OF "MONEY" AND A HISTORY OF THE MONETARY, BANKING, AND CREDIT SYSTEMS IN NEW ZEALAND FROM 1934 TO 1955

TABLE OF CONTENTS

Section One: Expansion and Contraction of the Supply of Money

I. WHAT IS MONEY?

1. Since money is such an important factor in our lives, it may seem surprising that it is difficult to decide just what money is. But, in practice, it is not a simple task to draw the line between things which are obviously money and those which are nearly money but not quite.

2. The only things which must legally be accepted in payment are Reserve Bank notes and coin. Even with coin, there are limitations, for a tender of payment is legal tender only up to forty shillings in silver and cupro-nickel coin and up to one shilling in bronze coin.

3. But in everyday usage money is anything which is immediately available and generally acceptable in payment for goods and services or in settlement of a debt. A definition confined to legal tender money would exclude deposits on current account, transferable by cheque, which are the most important means of payment in use in New Zealand today. These are entries in the books of a bank acknowledging the indebtedness of the banker to clients who have lodged notes, coin, or cheques in their accounts at his bank, or sold him foreign exchange or some other asset. When he is directed to do so by cheque, the banker will immediately supply notes or coin or transfer to other persons sums standing to his client's credit. Since these current account deposits are immediately available and generally acceptable, and since nowadays a very large proportion of transactions is financed by transfers of such deposits by cheque, there is obviously a strong case for including them as part of the supply of money.

4. Accordingly, the Reserve Bank has chosen the following items as the components of the money supply in New Zealand:

(a) The coin in circulation;

(b) The value of notes issued by the Reserve Bank minus those held by the trading banks to pay out to customers who want to convert deposits into notes;

(c) The "demand liabilities of the Reserve Bank" (excluding the deposits held there as a reserve by the trading banks), which is another way of saying the credit balances of the Government, some of its Departments, and certain statutory marketing organisations which have the privilege of banking with the Reserve Bank; and

(d) The "demand liabilities of the trading banks", which means the deposits of customers on current account at the trading banks.

5. There is, however, no universal agreement on what should be included in the money supply. Most countries agree that coin, notes in circulation, and demand liabilities of the trading banks are money. But many (e.g., Canada, the United States, and Ceylon) exclude Government deposits at the central bank; and others include items which are left out in New Zealand (e.g., Australia includes time deposits with the trading banks and deposits with all savings banks).

6. For New Zealand, we consider that it is appropriate that Government deposits at the Reserve Bank should continue to be regarded as part of the money supply for statistical purposes. Presumably they are excluded overseas because Governments may sometimes accumulate balances at the central bank as an anti-inflationary measure; but in New

Zealand, at least up till the present, it is more reasonable to regard the Reserve Bank's demand liabilities, apart from the trading banks' deposits there, as sums liable to be spent in the near future.

7. We consider that it would also be desirable in future to include the unexercised portion of overdraft authorities granted by the trading banks. In some other countries, when a trading bank makes a loan, it credits the customer's account to the full amount of the loan and he pays interest on this amount until it is repaid. Current account deposits, and therefore the volume of money, are immediately increased by the full amount of the loan whether or not the deposits are immediately or fully used for payments. In New Zealand, the practice is for the banker to grant his customer an overdraft limit, i.e., authority to overdraw his account up to a specified amount, the borrower paying interest only on the amount by which he is overdrawn at any time.

8. But the unused limit is, in principle, similar to a deposit standing to a customer's credit at the bank. He may at any time draw cheques up to the authorised amount, and the sums so drawn will be just as acceptable as cheques drawn against a deposit account. It may be argued that some of the unexercised overdraft authorities are purely nominal and not likely to be fully used. This is true, but we have been informed in evidence that many deposits on current account at the trading banks also lie idle for fairly long periods. What matters, according to the definition of money which we have adopted (and the Reserve Bank approves one which is very similar) is that the thing concerned should be "immediately available and generally acceptable in payment". Unexercised overdraft authorities clearly satisfy these criteria.

9. A fairly strong case can also be made for including in the volume of money savings-bank deposits, which can be withdrawn on demand, and deposits on call at various trading concerns, such as stock and station agents. In particular, deposits at the Invercargill Savings Bank are transferable from one customer to another by cheque and so appear to satisfy our criteria of moneyness. In general, however, savings-bank deposits themselves are not generally acceptable in payment. Withdrawals are made in the form of notes or coins from savings-bank tills, or, for larger payments, in the form of cheques drawn on the balances which the savings banks hold at the trading banks or, in the case of the Post Office, at the Reserve Bank – and all of these are already included in the volume of money. Similarly, some stock and station agents allow customers to transfer deposits placed with them to other people by order or cheque. Normally, however, such a transfer would at the same time involve the transfer to the payee of a deposit to the credit of the agency firm at a trading bank – and this is already included in the volume of money.

10. On balance, then, we feel that the Reserve Bank is justified in excluding deposits at savings banks and trading companies in its calculations of the money supply. But they are obviously important sources of purchasing power (e.g., about £113 million was withdrawn from the Post Office Savings Bank alone in the year ended March 1955) and the total of these deposits must certainly be taken into consideration by anyone who is attempting to estimate potential demand for goods and services. In this connection, it is surprising that there are no reliable figures of the total value of deposits on call at stock and station agencies and other trading concerns. This is an omission which we recommend should be remedied as soon as possible.

11. There are other things which can be fairly quickly converted into money but which are not themselves money. For example, time deposits at the trading banks or at some other financial institutions are in theory not available for withdrawal until an agreed period has expired. In practice, it is possible in special circumstances to arrange for a release from such an agreement but since this does not appear to be customary, it seems preferable to exclude time deposits from the money supply. Again, Government securities and some company shares can be converted quickly – although not necessarily without loss of capital value – into money by sale on the Stock Exchange, but it would be unreasonable to class them as money.

12. When all this is taken into account it is clear that the selection of items for inclusion in official statistics of the money supply must be to some extent arbitrary. As the Statistics Division of the International Monetary Fund has appropriately stated, *"assets put in the category of money are not money to some holders and assets excluded from the category of money are money to others. Since there is no wholly satisfactory definition of money, there is no clear boundary to separate the monetary system from financial institutions of all kinds"*. We shall return to the importance of this point when we discuss the "creation of money".

II. HOW OUR MONEY SUPPLY COMES INTO EXISTENCE

13. The evidence given before the Commission has made it obvious that the way in which our supply of money comes into existence is not generally understood. Many witnesses seemed to think that the trading banks have a monopoly of the creation and destruction of money and that all money is created as an interest-bearing debt to the trading banks. Some argued that, if they wished, the banks could greatly increase the money supply without cost to themselves; one of the official Social Credit witnesses went so far as to say that a trading bank did not require either shareholders' funds or deposits to enable it to create money. In the light of statements such as these, it seems desirable to discuss in some detail the means by which our money supply may be expanded or reduced.

COIN AND NOTES

14. The right to mint coin is a prerogative of the Crown. Nowadays coin comprises only a very small proportion of the total volume of money; and its supply is varied purely in accordance with the public demand for it. The Reserve Bank advises the Treasury from time to time how much coin it estimates will be required by the public, and the Treasury orders the necessary supplies from the Royal Mint. These are sold to the Reserve Bank at their full nominal value for distribution and the Reserve Bank in turn sells them to its customers, especially the trading banks and the Post Office Savings Bank, when they find it necessary to replenish their supplies to meet the demands of their depositors for coin. The trading banks and the Post Office pay for the coin by drawing on their deposits at the Reserve Bank.

15. Until 1934 each trading bank in New Zealand issued its own notes, but from 1 August of that year the Reserve Bank became the sole note-issuing authority. As with coin, the supply of notes varies solely in response to the demands of the public. If their customers want to convert a larger proportion of their deposits than usual into notes, the trading banks and the Post Office Savings Bank must buy the notes from the

Reserve Bank at their full nominal value, by drawing on their deposits there. In transactions of this kind, no change takes place in the total volume of money; the value of notes and coin in circulation increases, but this is offset by a fall in customers' demand deposits at the trading banks or in the deposits of the Post Office at the Reserve Bank. As is shown in the table given in Section Four of the report, the value of notes and coin in circulation has risen considerably since 1935. It will be observed, however, that the proportion of notes and coin to the total money supply has remained fairly constant at about 20 per cent. The increase in the value of notes and coin in circulation is an indication of increased spending by the public and is mainly a reflection of the increased volume of bank deposits which has been generated during the period.

BANK MONEY

(a) *The Creation and Destruction of Bank Money*

16. Bank money is the most important type of money in existence today. This includes demand deposits at the trading banks and at the Reserve Bank (except for the reserves of the trading banks at the Reserve Bank) and unexercised overdraft authorities. Bank money may be created in four main ways:

(i) When a customer lodges notes or coin to the credit of his account with a bank. This transaction does not affect in any way the total volume of money, because the notes or coin have merely been withdrawn temporarily from circulation.

(ii) When a customer of the Reserve Bank or a trading bank lodges, to the credit of his account, foreign exchange received from the sale of goods or services beyond New Zealand or the proceeds of a loan raised with an overseas lender. These transactions increase the volume of money as new bank money has come into existence.

(iii) When the Reserve Bank or a trading bank buys securities or other assets from an individual or firm and the proceeds are lodged to the credit of the seller's account at a bank. These transactions increase the volume of money as new bank money has come into existence.

(iv) When the Reserve Bank makes a loan to the Government or to marketing authorities. At first, the borrower's deposits at the Reserve Bank are increased, and when this money is spent, the recipients may lodge part of it in their accounts at the trading banks and retain part of it in circulation in the form of notes or coin.

(v) When a trading bank grants an overdraft limit to a customer. The volume of bank money increases immediately because the customer is then in a position to draw cheques against the overdraft authority to the amount of the limit granted to him. On the Reserve Bank definition, an increase in the volume of bank money does not occur until the borrower spends the money advanced and the recipient lodges the cheque with his bank as a demand deposit. This transaction also increases the volume of money because the customer has acquired purchasing power which he did not possess previously.

For the sake of clarity it has been assumed in each of the examples given above that the customer of the bank is making the lodgment in a credit account. If, however, the customer is working on a bank overdraft, bank money is still increased unless the customer's overdraft limit is at the same time reduced by an amount corresponding with the lodgment.

17. Conversely, the volume of bank money may be reduced:

(i) By customers converting their demand deposits or unexercised overdrafts into notes and coin;
(ii) By customers buying, with deposits or unexercised overdraft limits in their name at the trading banks or the Reserve Bank, overseas exchange to meet obligations overseas;
(iii) By banks selling their holdings of securities or other assets;
(iv) By a reduction of advances by the Reserve Bank; or
(v) By a reduction of overdraft limits by the trading banks.

18. It is important to recognise the difference in the effect on the volume of money between lending or the purchase of assets by a bank on the one hand and lending or the purchase of assets by an individual or firm on the other. In the latter case, the individual or firm making the loan or buying the asset parts with his money to the borrower or seller; when a bank lends or buys assets, however, none of those who already held demand deposits before the transaction took place gives up his right to use that deposit when he wishes; i.e., the supply of bank money existing before the transaction is not affected, but the borrower or the seller of the asset bought by the bank usually receives new bank money in the form of a deposit or of an overdraft limit from the bank. An increase in bank lending or purchase of assets therefore normally involves an increase in the total volume of money available to the public.

19. We should note that the well-known maxim that every bank loan creates a deposit and therefore increases the volume of money is subject to many qualifications; for an advance may be used to buy overseas exchange; or a cheque drawn against the overdraft may be used by the recipient to wipe out an overdraft; or notes and coin may be withdrawn from the bank by the borrowers and retained in circulation by the public. In none of these cases are deposits increased. Nor does every repayment of a bank loan involve the destruction of a deposit; for repayment may be made from a new advance or as the result of the lodgment of overseas exchange with the bank or as the result of the lodgment of domestic currency previously held in circulation by the public. But, in general, it is true that, when banks increase their lending or their purchases of other assets, the volume of demand deposits and, therefore, the volume of money is increased; and that, when their lending or purchases of other assets is reduced the volume of demand deposits and, therefore, the volume of money is reduced.

(b) *The Principles of Commercial Banking*

20. The fact that a large proportion of our money supply comes into existence as a result of the operations of the trading banks obviously disturbed many witnesses who appeared before us. A number seemed to think that this "creation of credit" by the banks was a relatively recent phenomenon. In fact, the fundamental principles of our banking system

have remained much the same since at least the seventeenth century. The principal functions of a trading or commercial bank today are similar to those which certain goldsmiths began to undertake in England at about that time, in that:

(i) They receive and take custody of money on behalf of customers, who thus avoid the risk of loss or theft involved in keeping notes and coin on their premises or person.

(ii) They exchange overseas money for domestic money and, vice versa, for customers who engage in business or travel overseas.

(iii) They provide their customers with a convenient means of payment, by undertaking to transfer sums standing to the customer's credit at the bank to other people, when directed to do so by cheque. (In times past, the trading banks could also issue notes to their customers in exchange for coin deposited with them, but the provision of notes is now, nearly everywhere, the monopoly of a central bank.)

(iv) Within limits, and subject to various controls, they make loans to people or firms deemed credit worthy; and lend to the Government or local bodies by buying their securities.

21. The main reason why a bank is able to make the latter loans is that, although its depositors can at any time withdraw their deposits in legal tender money or require the bank to transfer their money to customers of other banks, the banker, in practice, is called upon to pay out very little legal tender money in normal circumstances. This is so for several reasons:

(i) A few customers will never use the sums which they have deposited and some will let them lie idle for considerable periods. Evidence given by the Chairman of the Associated Banks and the Governor of the Reserve Bank indicated that, early in 1955, there were deposits of between £60 million and £85 million which had remained inactive in the accounts of customers of New Zealand trading banks for a considerable period of time.

(ii) Especially in a community where there are only a few banks, many of the cheques drawn by customers will be paid to other customers of the same bank. In these cases the bank will not have to transfer legal tender money to other banks, but merely debit one customer's account and credit another's.

(iii) Even though customers are constantly withdrawing notes and coin or making payments to customers of other banks, they are also constantly making further deposits of notes, coin, or cheques drawn on other banks, which more or less offset the withdrawals.

22. Thus, a banker can normally be certain that, on balance, he will have to convert only a very small proportion of his customers' deposits into notes and coin at any one time. He has no need, then, to keep a reserve of coins and notes equal to the total of the deposits standing to the credit of his customers; he can obviously lend some money out at interest for short periods without any danger of his being unable to meet his customers' demands for notes and coin as required.

23. Loans could be made either directly in notes and coin or by giving the borrower a title to notes and coin. Most borrowers find the latter more convenient and take their loans in the form of an overdraft limit with the bank which they can draw on by cheque at any time. Whichever method of lending he adopts, the banker obviously incurs more promises to repay notes and coin than he could immediately honour at any one time if all his depositors chose to ask for repayment at once. Also, whichever method of lending he adopts, he obviously increases the amount of money available to the community when he increases his loans. The people who have left money with him still have the deposits with which he has credited them and which they can use at any time to make payments; but he is either issuing more bank money or putting into circulation some of the notes and coin to which others already hold title. He can thus be said to be creating money as a result of his lending.

24. The fact that banks "create money" in this way is not a new discovery, as some witnesses implied. For example, in the *Economic Writings of Sir William Petty* (1623–87), Vol. II, page 446, we find:

Question 26:

What remedy is there if we have too little Money?

Answer:

We must erect a Bank, which well computed, doth almost double the effect of our coined Money.

And Francis Cradocke, a London merchant appointed by Charles II as a member of the Board of Trade, said:

A Banke is a certain number of sufficient men of Credit joined together in a stock, as it were, for keeping several men's cash in one Treasury and letting out Imaginary Money (i.e. Credit) at interest for three or more in the hundred per annum, to tradesmen or others that agree with them for the same; and making payment thereof by assignation, passing each man's account from one to another, yet paying little money.

Mr H. D. Macleod, from whose book *The Theory of Credit,* written in 1894, the above quotation comes, defined a banker as *"A Trader who buys Money and Credits, Debts or Rights of action payable at a future time by creating and issuing Credits, Debts, or Rights of action payable on demand"*. Several other quotations on this subject are given in Part II of Appendix D.

(c) *The Limits to the Creation of Money*

25. The more a banker lends, the more profit he can make, but the more also he contracts to repay or transfer in legal tender money. In the past, some bankers have gone beyond the bounds of prudence in their lending and, faced with a more rapid demand than they had expected by their customers for notes and coin or for transfers of their deposits to customers of other banks, have found themselves with insufficient reserves, and unable to call in their loans quickly enough to fulfil their obligations. Their depositors' faith in them having gone, they were forced to close their doors (e.g., according to one authority in the United States, where there are many small local banks, *"the history of bank failures and losses to depositors has been a grievous one . . . only about one half the banks in existence in 1915 are still solvent"* (in 1955). New Zealand has been fortunate in the relative stability of its banking system. The financial strength of the trading banks here has never been called into question

since the 1890's, but, at that time, the Bank of New Zealand was kept in operation only through the help of the State, and the Colonial Bank had to be wound up, its sounder accounts being taken over by the Bank of New Zealand.

26. It was soon learned that the primary duty of a banker – and a basic necessity if bank lending was to be possible at all – was to safeguard the deposits entrusted to him. If depositors began to fear that their banker could not meet their demands for legal tender money or transfers of their deposits, they would naturally want immediately to convert their deposits into money which was generally acceptable, rather than retain title to notes or coin which might be repudiated when presented. A "run on the bank" would begin. The large-scale withdrawal of notes and coin would destroy the basis on which the banker's lending had been built and force him to call in loans, often at great inconvenience to the borrowers, in order to meet his commitments to depositors.

27. Prudent bankers, therefore, always keep reserves of bankers' cash (i.e., notes, coin, or balances at the central bank) and of overseas exchange, which bear a reasonable proportion to their customers' deposits. A banker's lending is therefore obviously limited by the amount of legal tender money which people are willing to leave with him, and by the availability of credit-worthy borrowers who want the type of relatively short-term loan which he is prepared to make. Once the ratio between his reserves of banker's cash and overseas exchange and his liabilities to repay are at the minimum which he has found to be prudent, he can lend no more unless he obtains more reserves. Naturally, competition between bankers to acquire reserves as a basis for lending has led to the virtual elimination of charges for keeping deposits. In some cases it has led to the payment of interest on deposits, especially when a person is willing to leave money on deposit for a stipulated period, thus reducing the immediate risks of the banker's being asked to pay out legal tender money to customers or to other banks.

28. The banker is unable to create unlimited amounts of money by a stroke of his pen as sometimes alleged. Before he can lend to any extent he must have substantial reserves which he can maintain only if a substantial volume of deposits is left with him by his customers. And his customers are willing to leave deposits with him only if they know that they can make payments with them or convert them into notes and coin on demand. The banker thus attracts the deposits necessary for lending primarily by providing an acceptable means of payment. It has truly been said that the "success of the banker as a provider of means of payment depends upon his success as a lender and borrower; and his success as a lender and borrower depends upon his success in providing a means of payment. The two aspects of his business are interdependent".

29. The fundamental principles of bank lending outlined above have remained basically the same for three centuries and apply in New Zealand as in other countries. However, we must now examine the peculiar features of the New Zealand banking system and the principal changes which have taken place in the system since 1934.

(d) *Banking in New Zealand in 1934*

30. When the Parliamentary Monetary Committee reported in 1934, the Reserve Bank had not yet begun operation. The provision of both notes and bank money was still solely in the hands of the six trading banks which were operating in New Zealand at that time. As the Committee's report points out, the major factor then governing the lending of the banks and the supply of money available in New Zealand was New Zealand's overseas trading position. The notes and deposits of the banks were generally in practice, if not by law, convertible into sterling on demand in the same way as the goldsmith's notes and deposits had been convertible into gold in the seventeenth century. Sterling funds were therefore the basic reserves of the trading banks at that time. But, of course, only a proportion of their liabilities was likely to be converted into sterling at any one time. The banks could therefore lend to private individuals or to the Government, thus adding to the volume of money available. But, as is the case with all bankers, the extent to which they could lend was limited. Prudence demanded that a reasonable reserve of overseas exchange in relation to their liabilities should be maintained at all times. If they expanded their lending too far in relation to their sterling funds, they were in danger of creating a greater demand for overseas exchange than they could meet; for, by expanding their lending, they would facilitate greater spending on imports, either directly by some of those obtaining the overdrafts, or indirectly by some of those who obtained control of the extra money made available to borrowers who spent it within New Zealand.

31. The banks maintained offices in London which received the proceeds of sales of New Zealand goods and services overseas. The exporter would either be credited with a demand deposit or have his overdraft reduced at his bank in New Zealand to the extent of the New Zealand equivalent of his overseas earnings; the bank would add the sterling to its balances in London. On the other hand, New Zealand importers settled their debts to traders overseas through the banks. An importer would pay to his banker by cheque the New Zealand equivalent of his debt overseas, thus either reducing his deposits at the bank or increasing his overdraft; the bank would pay the overseas trader by drawing on its reserve of sterling in London. In addition, loans raised by the New Zealand Government or private citizens overseas would raise the sterling balances of the banks, and add to deposits or reduce advances in New Zealand; the opposite would apply when loans were repaid.

32. If New Zealand's overseas receipts exceeded the payments made outside the country during any period, the banks accumulated larger reserves of sterling exchange; at the same time, the deposits of customers tended to rise and advances in the first instance to fall in New Zealand as a result of repayment. But the rise in their reserves of sterling encouraged and enabled the banks to restore and increase their advances, if they could find credit-worthy borrowers. Thus, a surplus in the balance of payments generally led to easier credit conditions in New Zealand. The volume of bank money available in New Zealand rose (i) because of the extra deposits made available to people and firms in New Zealand as a result of the excess of overseas receipts over payments, and (ii) because people and firms were granted increased overdraft limits by the banks, which, when used, subsequently led to an increase in demand deposits or notes in circulation.

33. Conversely, if overseas payments exceeded overseas receipts, the banks' sterling reserves fell while, in New Zealand, advances in the first instance tended to rise as bank customers felt the need for accommodation and deposits to fall. When this happened the banks normally became more conservative in their lending policies to ensure that the drain on their sterling balances did not become so great as to force them to suspend the conversion of notes and deposits into sterling on demand. The volume of bank money then tended to fall (i) directly because of the excess of overseas payments over receipts, and (ii) because of the banks' decision not to renew some overdrafts which were repaid, leading to a fall in the overdraft limits, demand deposits, or notes available.

34. Thus, before the institution of the Reserve Bank, changes in New Zealand's balance of payments, and the consequential changes in the banks' reserves of foreign exchange, were the primary factors governing the volume of money made available in New Zealand.

35. With the provision of money entirely in the hands of six competitive trading banks, five of which had their head offices outside the country, and four of which were mainly Australian institutions, there was little possibility of a co-ordinated financial policy being adopted in the national interest. The tendency was for advances to be excessively expanded when export receipts were buoyant, and for advances to fall considerably when export receipts were reduced. Thus, monetary developments tended to accentuate, rather than to offset, the internal effects of economic fluctuations overseas. It was recognition of these defects that led the New Zealand Government in 1934 to set up a central bank which would have a monopoly of the issue of notes, act as the banker of the Government and of the trading banks, and control currency and credit in the national interest.

(e) *Banking in New Zealand Since 1934*

36. The setting up of the Reserve Bank in 1934 did not, of course, reduce the importance of New Zealand's trade position as a factor governing the volume of money and the national income in New Zealand; nor did it alter the fundamental principles of bank lending. But it led to some important changes in the structure of the monetary system which we must now consider.

37. We do not at this point deal in detail with the structure and functions of the Reserve Bank and the trading banks, but merely with those aspects of their business which have a direct bearing on the creation and destruction of bank money.

38. The Act establishing the Reserve Bank gave it a monopoly of the issue of notes in New Zealand. It was at first required to convert these notes into sterling on demand (at a rate of exchange to be determined by itself), and to keep a minimum reserve equivalent to 25 per cent of its notes and other demand liabilities in the form of gold and sterling exchange. (In 1950 the latter provision was altered and the bank was required merely to maintain reserves of gold or sterling exchange, or foreign money which could be converted into gold or sterling exchange, which in the opinion of the Board of the Bank would provide a "reasonable margin for contingencies after taking into account prospective receipts and disbursements of overseas funds, and having

regard to the economic position within New Zealand.") As a result of these provisions of the Act, the primary responsibility for safeguarding the exchange reserves of the banking system passed from the trading banks to the Reserve Bank.

39. The Reserve Bank also took over from the Bank of New Zealand in 1934 the banking business of the Government. It now held the deposits of the Government and its various Departments; it could make advances to or buy securities from the Government; it could buy securities itself on the open market in New Zealand; and later it was also given power to make advances to Government Departments or statutory organisations engaged in marketing primary produce. Thus the trading banks no longer had a monopoly of the creation of bank money in New Zealand.

40. Even before the Reserve Bank came into operation it could not have been said that the creation of bank money was purely a private monopoly, because the State had a controlling interest in the Bank of New Zealand which did the largest volume of banking business in the country, and which was eventually nationalised as from 1 November 1945.

41. But the creation of the Reserve Bank and its subsequent complete nationalisation in 1936 left no doubt not only that the Government could issue additional money through the Reserve Bank, but also that the actual amount of bank money put into circulation could be controlled by State authorities in the public interest.

42. The Government and the Reserve Bank obtained powerful weapons with which to regulate the ability of the trading banks to lend. For example, if the Government borrowed money from the Reserve Bank and spent it on public works, most of the Reserve Bank notes, or cheques drawn on the Reserve Bank, which were paid out to those doing the work, would eventually be lodged with the trading banks. The banks would present them to the Reserve Bank for payment and would be credited with the equivalent amount as a deposit. This deposit, which was in any case convertible into sterling, was just as good as an addition to their reserves of foreign exchange as a basis for extra lending to the public, if they could find sufficient credit-worthy people wishing to borrow.

43. Conversely, if the Government decided to accumulate at the Reserve Bank some of the money which it collected by taxation or borrowing from the public instead of spending it, the balances of the trading banks at the Reserve Bank would be reduced; for the cheques drawn on the trading banks by taxpayers or subscribers to Government loans would be paid by the Government into the Reserve Bank, which would take payment from the trading banks by reducing their balances at the Reserve Bank. Since the banks were still bound by the necessity to maintain a sufficient ratio between their reserves (which now included their balances at the Reserve Bank) and their obligations to their depositors, their ability to lend would also be reduced.

44. The trading banks were required by the 1934 Act to maintain at the Reserve Bank balances equal to not less than 7 per cent of their demand liabilities and 3 per cent of their time liabilities. Deposits to build up these balances could be made in the form of gold or foreign exchange or Reserve Bank notes (or in practice, of course, cheques

drawn by the Government on their balances at the Reserve Bank which could readily be converted into notes if desired). In special circumstances deposits could be made in the form of securities acceptable to the bank. The original purpose of these clauses in the Act was not mainly to provide a method of controlling the lending operations of the trading banks, but in the words of the then Minister of Finance:

> The centralisation of the cash resources of the commercial banks not only provides a method of control for the central institution, but greatly strengthens the whole banking system. In one pool the combined reserves will safely support a much greater credit structure than the same aggregate amount held by half a dozen banks. The analogy of a water-supply is appropriate. If everybody in a town had a few buckets of water and held on to them when a fire started, the whole town would be destroyed. If, however, the whole supply is collected in a central reservoir the outbreak could be dealt with effectively as soon as it was discovered. At present each commercial bank has to carry sufficient reserves to meet any possible financial strain, but with the central institution to fall back on an appreciably smaller cash reserve is needed.

45. An important change in this provision was made in 1936 when the Governor of the Reserve Bank was given power, with the authority of the Minister of Finance, to vary the proportions of their liabilities which the trading banks were required to keep at the bank, although he could not reduce these proportions below the original figures of 7 per cent and 3 per cent. This change made it possible for the trading banks' ability to lend to be varied directly by raising or lowering the minimum reserve ratios. The only country which had adopted such a system of variable reserve ratios before 1936 was the United States.

46. A simple example will illustrate the way in which variation in the ratios may influence bank lending. Assume that the banks have balances at the Reserve Bank of £7 million against their customers' demand deposits of £100 million and that the statutory minimum reserve ratio is 7 per cent in respect of demand deposits. (For simplicity, we shall ignore the requirement in respect of time deposits.) If the Governor of the bank and the Minister of Finance wish to reduce the level of bank lending, they may raise the ratio to say 9 per cent. The banks would then require a deposit of £9 million at the Reserve Bank to fulfill their minimum requirements. Since they cannot create £2 million of gold, overseas exchange, or Reserve Bank notes themselves, they are forced in the first instance to borrow that amount from the Reserve Bank to keep within the law, at a rate of interest prescribed by the Board of the bank. The Reserve Bank could, if it wished, vary the reserve requirements, and the rate of interest at which it would lend to the trading banks, in such a way as to make it completely unprofitable for the banks to continue borrowing from it. Thus the banks could be induced to take steps to avoid the necessity of borrowing from the Reserve Bank. They would be likely to attempt to build up their balances at the Reserve Bank and to reduce their customers' deposits by being more cautious in granting new overdrafts and by reviewing existing overdraft limits. They could also sell some of their securities or other assets or, as a last resort, call in advances from some of their customers. The Reserve Bank's ability to raise the minimum reserve ratios and the rate of interest at which it will lend to the banks therefore provides it with a powerful means of curbing lending by the trading banks if this is deemed desirable. Conversely, the power to lower the ratios again could be used if it was thought desirable to increase the trading banks' ability to lend.

47. The Government took other steps during the war to control the level and direction of lending by the trading banks. Firstly, in January 1942, with the co-operation of the trading banks themselves, a policy of selective control of bank advances was introduced by the Reserve Bank. This was designed to prevent the expansion of bank credit for speculative and luxury purposes, for purchases of property, and so on. Although it was not specifically designed to reduce or limit the total of advances it was bound to restrict their expansion to some extent. With some modifications this policy has been continued up till the present time. Secondly, from 1943 onwards, as a matter of Government policy, the trading banks were precluded from increasing their holdings of Government securities, and their existing holdings of Government stock were repaid as they matured. This policy has been continued up till the present time, with the exceptions that after 1950 the trading banks were permitted to maintain their existing holdings of Government stock and, in 1954, were invited to take up £12 million of State Advances Corporation stock.

48. As a result of these changes, not only is the ability of the trading banks to create bank money limited today, as in the past, by the necessity to maintain a prudent ratio between their reserves and their customers' deposits, but it can also be controlled in the public interest through variation by the Reserve Bank of the reserve ratios and its discount rate. Alternatively, the cash reserves of the trading banks and therefore their ability to lend can be increased or reduced by Government borrowing from the Reserve Bank on the one hand or by the Government building up balances or paying off its debt there on the other. Moreover, the direction of the trading banks' lending is influenced to some extent by the selective advance control policy and by control over the purchase of securities. These are important changes in the structure of the banking system in comparison with the situation existing before 1934.

49. It is important, however, not to over-emphasise the extent of the changes which have taken place in the past two decades. As we saw earlier, prior to 1934, the volume of bank money put into circulation in New Zealand depended mainly on the country's overseas trading position and the level of its exchange reserves. Some witnesses seemed to feel that these factors now neither did, nor should, influence the extent to which bank money could be created in New Zealand. For reasons given below we believe that this view is mistaken. It appears to have its roots in circumstances which have been peculiar to the period which we are considering, and which cannot be counted upon to recur in the future.

50. In 1938 it was made clear that we cannot ignore the limitations imposed by the country's overseas exchange reserves on the extent to which the volume of money can be expanded in New Zealand, at least when the citizens of the country are free to spend or send their money overseas as they wish. In that year, our exchange reserves fell to a dangerously low level as a result of a combination of a decline in export receipts, heavy spending on imports stimulated by expansion of Reserve Bank and trading bank credit, and fairly substantial remittances of capital from the country.

51. This situation was met, not by the contraction of credit, but by the introduction of comprehensive import and exchange controls. No goods could be imported into the country without a licence or a special exemption from the necessity to obtain a licence. The Reserve Bank was released from its obligation to convert its notes into sterling; all exports were made subject to licence, and licences were issued only on condition that the exchange proceeds were paid to a New Zealand bank; a permit was required before any overseas payments could be made; and the Reserve Bank was given power to require the trading banks to sell their overseas exchange to it. In 1940 the Reserve Bank was also given authority to compel the sale to it of all foreign moneys and securities held by New Zealand residents. Thus, for many years after 1938, a system of direct control over imports and other exchange transactions was used to keep overseas payments in check, irrespective of the level of bank lending in New Zealand.

52. The traditional necessity to limit the expansion of the volume of money in New Zealand in order to preserve an adequate level of exchange reserves was obscured for over a decade after 1938 by the maintenance of these import and exchange controls, and by other factors peculiar to the period. Shortages of imported goods during the war and early post-war years, the imposition of comprehensive direct controls over the level of income and spending in New Zealand, the selective advance control policy, and the Government's policy on bank purchases of securities, all tended to hold down the demand for bank credit. In addition, a combination of relatively low imports and continually rising export receipts enabled substantial reserves of foreign exchange to be accumulated, despite large repayments of overseas debt.

53. However, from 1947 onwards, imports became more readily available, and the controls over domestic incomes and spending were gradually relaxed. After the wool boom in 1950–51, import control was removed from a wide range of goods. The volume of money rose from £187 million in March 1947 to £291 million in March 1951 mainly as a result of an expansion of Reserve Bank and trading-bank credit. The collapse of the boom in wool prices in the subsequent year, which coincided with a substantial upsurge in imports, led to a large deficit in the balance of payments. The country's reserves of overseas exchange were then being reduced at such a rate that it was again felt necessary to introduce direct controls over imports, this time in the form of allocations of exchange by the Reserve Bank.

54. It was once more apparent that if people are to be allowed to spend relatively freely on imported goods, the level of spending in New Zealand, and therefore the volume of bank money which is an important element in making it possible for people to spend, must not be execessively expanded. The substantial deficit in the balance of payments in 1954–55, after exchange allocation had been removed and the volume of bank credit had again been permitted to rise substantially, reiterated this important lesson.

(f) *Factors Governing the Supply of Bank Money Today*

55. To sum up, in New Zealand at present the supply of bank money is generally increased if the Reserve Bank or trading banks buy more overseas exchange than they sell or if they increase their lending or purchases of other assets. Conversely, the supply of bank money is generally reduced if the Reserve Bank or trading banks sell more overseas exchange than they buy or reduce their lending or purchases of other assets.

56. The extent to which the trading banks can lend or buy assets and increase the supply of money depends on several factors:

(i) The amount of cash (i.e., notes, coin, and balances at the Reserve Bank) and overseas exchange which they can obtain, for they must keep a prudent proportion between these assets and their liabilities to their customers. (In turn, their holdings of cash and foreign exchange are influenced by the country's balance of payments, the Government's fiscal policy, and the extent to which the public wish to hold notes and coin in circulation.)

(ii) The proportions of their customers' deposits which they are required under the reserve ratio system to maintain as balances at the Reserve Bank and the rate of interest which they are required to pay to borrow money from the Reserve Bank.

(iii) The other controls over advances and investments imposed by the Reserve Bank and the Government.

(iv) The demand by credit-worthy members of the public or by the Government for bank credit. A bank cannot lend if nobody wants to borrow.

57. As far as creation of bank money by the Reserve Bank is concerned, before 1950 there was a specific legal limit on its power to expand its lending or purchases of assets. This limitation took the form of an obligation to maintain reserves of gold or sterling exchange equal to at least 25 per cent of its notes and other demand liabilities. Now the Reserve Bank is bound merely to keep such reserves of gold, sterling, or other exchange as the Board thinks provide "a reasonable margin for contingencies". But the interest of the Reserve Bank does not lie in expanding its lending in order to make profits. It is charged with the duty of doing "all such things within the limits of its powers as it deems necessary or desirable to promote and safeguard a stable national price level and the highest degree of production, trade, and employment that can be achieved by monetary action", and of giving "effect as far as may be to the monetary policy of the Government, as communicated to it from time to time by the Minister of Finance". Unfortunately, as we point out in Section Two of our report, these objectives are not at all times completely consistent with one another. But the Reserve Bank's primary function is so to regulate its own creation of bank money and that of the trading banks as to contribute to their achievement as far as possible. We consider in Section Seven of our report how successful it has been in the exercise of this function.

(g) *Some Misconceptions About the Creation and Destruction of Bank Money*

58. It is desirable to clear up certain misconceptions about the provision of money by the trading banks which seemed to be common to several of the witnesses appearing before us.

(i) *Are the Banks Alone Responsible for Expansion and Contraction of Bank Credit?*

59. Many witnesses appeared to believe that the trading banks contracted or expanded credit with the deliberate purpose of bringing about a certain course of economic events. The witnesses did not appear to appreciate that the basic cause of variations in the volume of trading-bank credit is the action of customers of the banks. In granting overdrafts, banks are responding to the requirements of their customers. In times of prosperity the demands on the banks for accommodation are greatly increased, and it is not surprising that, if the Reserve Bank permits the trading banks to hold excess reserves of cash, their advances rise. On the other hand certain witnesses alleged that the banks deliberately contract their lending in times of depression. It is true that in times of economic stress the banks pay particular attention to advances made to customers who, through a change in economic circumstances generally, appear to be leaning too heavily on bank credit, but the critics put far too little emphasis on the natural and necessary tendency of business men to reduce stocks and their general financial requirements in times of a recession in trade. The automatic effect of this tendency is to reduce the demand for bank credit and in this way to contract the volume of lending by the banks.

(ii) *Are Trading Banks Peculiar in Not Lending the Deposits of Their Customers?*

60. Some witnesses attached great importance to the fact that a trading bank does not lend the deposits which are left with it by its customers. They pointed out that when a trading bank grants an overdraft and the borrower draws a cheque against it, which the recipient deposits in his own bank, a new deposit is created without any reduction in the deposits standing to the credit of other customers of the banks. This is true, but it is not peculiar to the operations of the trading banks. For instance, when deposits in a savings bank increase more rapidly than withdrawals, a savings bank is in a position to increase its lending or to buy more securities. In this way it transfers to the borrower or to the seller of the securities some of the extra notes or bank deposits which it has acquired. But the depositors at the savings bank who have made available the money which has been lent out do not give up their rights to withdraw their deposits on demand.

61. The vital distinction between the operations of the trading banks and the operations of the savings banks rests in the fact that, when trading banks increase their lending, the supply of bank money (which is used by most people to meet their day-to-day expenses) is increased. The savings banks merely transfer part of the existing supply of money from one person or institution to another. In the process, the total of savings-bank deposits may increase, but these are not normally used to meet day-to-day expenses. They are normally left in the savings bank for some time and later withdrawn in cash for some special purpose.

A given amount of trading-bank deposits therefore finances a much greater volume of spending during a year than the same amount of savings-banks deposits, and this is why the operations of the trading banks must be more closely controlled.

(iii) *Can Trading Banks Create the Money They Lend Without Needing to Borrow from the Public and Without Cost to Themselves?*

62. Several witnesses claimed that, unlike other financial institutions which have to borrow money already in existence before they can lend anything at all, the trading banks create the money they lend without cost to themselves. This is a gross exaggeration of the power of the trading banks.

63. We have already stressed that, in fact, a trading bank can lend only to the extent that its reserves of bankers' cash allow. They must be adequate to meet any conceivable demands by its customers for notes, coin, or foreign exchange, to preserve customers' confidence in its ability to meet their requirements immediately, and to meet the minimum statutory balance which it is currently required to keep at the Reserve Bank. The bank can maintain this cash reserve only if people are willing to leave deposits with it. If a much larger number of its depositors than usual suddenly decided to convert their deposits into notes, coin, or foreign exchange, or transfer them to customers of other banks, the bank would be forced to sell some of its investments and call up some of its advances to enable it to meet their demands. Thus a trading bank's ability to lend depends on its ability to induce people to leave deposits with it, and these are clearly debts of the bank to its customers. The trading bank, like other financial institutions, must therefore borrow in order to lend.

64. Some witnesses drew attention to the fact that a trading bank pays interest on only a small proportion of its total deposits, while a savings bank pays interest on all deposits, despite the fact that they can be withdrawn at call. They implied that the trading bank had an unfair advantage in this respect and should have to borrow on terms similar to those offered by other financial institutions. But it must be remembered that, although a trading bank pays interest only on fixed deposits, it provides for depositors having funds on current account the facility of being able to transfer these funds to other people by cheque, this service being rendered at a charge which by no means covers the direct costs involved. Without inducements of this nature, people would be unlikely to leave money on deposit with the trading banks if they could obtain interest elsewhere.

65. The Associated Banks have estimated that about three-quarters of the total staff of the banks, involving approximately two-thirds of the total salaries bill, are employed in the conduct of the current account system (i.e., in cashing cheques; posting cheques, bills, and credits to individual customers' accounts; the provision of statements to customers; the issue of cheque books; and the handling of cheques drawn on other branches). That means that 5,000 men and women, earning salaries totalling about £3 million annually, are engaged in providing chequing services. Add to this the annual cost of the stationery involved (which the banks say reaches between £200,000 and £300,000) and the equipment used, and it will be seen that the attraction and maintenance of the deposits, without which the trading banks would be unable to lend, is by no means costless.

(iv) *Can Trading Banks Lend Out any More than the Extra Cash They Receive from Time to Time?*

66. One or two witnesses doubted whether trading banks really had the power to create money at all; in practice, they argued, they merely lent out sums equivalent to any bankers' cash which they might have in excess of the minimum reserves which they were bound, whether by prudence or by law, to maintain. Others argued that the banks, if unrestrained by the Government or Reserve Bank, could create bank money to a value several times in excess of any additions to their cash reserves. Strangely enough, there is a large element of truth in both views. The first is broadly correct if we look at the operations of an individual bank competing with several others; the second is correct if we look at the operations of the banking system as a whole.

67. Let us look, first of all, at the position of an individual trading bank which does, say, one-fifth of the trading business of the country. Assume: (i) that the minimum ratio which it feels bound for reasons of prudence to keep between its reserves and its customers' demand deposits is 20 per cent; (ii) that it has reserves £1 million greater than its minimum requirements, but that the other banks have no excess reserves; (iii) that it has a manager who believes that he can immediately grant extra overdrafts to a value of five times the amount of reserves he has in excess of his minimum requirements; and (iv) that he finds people who are willing to borrow £5 million and who spend it all within the country. When these people draw cheques against this sum to pay for goods and services rendered, the recipients deposit the cheques in their banks. But since the bank which granted the overdrafts does only one-fifth of the banking business, it will probably receive cheques worth only £1 million; the other £4 million will be lodged with its competitors. They, in turn, will present the cheques to the bank upon which they are drawn for payment and this bank will have to transfer to them £4 million of its balance at the Reserve Bank. Thus it loses not only the £1 million which it originally had in excess of its needs at the Reserve Bank but £3 million more. As its customers' deposits have now risen by £1 million, and its reserves have fallen by £4 million, it is obviously no longer meeting its minimum reserve requirements. It may eventually get back some of the cash which it has lost, if the other banks increase their lending on the basis of their increased cash reserves, but it cannot rely on this happening rapidly, and, in any case, it will never receive enough from its competitors to make up for the cash which it originally lost.

68. Of course, the position would have been different if the bank with the excess reserves had had no competitors. If it were the only bank in the country, it could reasonably expect that, if the overdrafts it had granted were spent within the country, the great bulk of the cheques drawn against them would be deposited with it, because those with the overdrafts would be paying other customers of the bank. In these circumstances, none of the bank's cash need be transferred at all. The lodgment of cheques to the value of £5 million against the new overdrafts granted would raise the bank's deposits by £5 million. Since it retained the extra £1 million of cash, which is 20 per cent of the addition to its deposits, it could still satisfy its minimum reserve requirements. Thus a bank with a monopoly of the banking business of the country could immediately expand its lending by several times any addition to its excess

reserves of cash. But an individual bank in competition with several others cannot safely lend any more than an amount equivalent to the bankers' cash it has in excess of its minimum requirements, unless it knows other banks also have excess reserves and are likely to increase their lending in step with it. It is not surprising, in the light of this, that many bankers in the past have denied that they have the power to create money.

69. But even in a competitive banking system, what cannot be done by an individual bank can be done as a result of the operation of the system as a whole. Let us start again with an individual bank, just meeting its prudent minimum reserve ratio of 20 per cent and having excess reserves of £1 million. This time, the manager increases overdrafts by only £1 million, knowing then that, even if all the cheques drawn by the borrowers were paid to customers of other banks, he would still satisfy his minimum reserve requirements. But the process does not end there. The banks which receive the cheques obtain an addition both to their deposit liabilities and to their cash reserves of £1 million. (Some may, of course, be lodged with our original bank.) Therefore, the banks receiving the cheques now have cash reserves in excess of their minimum requirements. They, in turn, after setting aside as a reserve 20 per cent of their new deposits, or a total of £200,000, can increase their lending by a total of £800,000 if credit-worthy borrowers want overdrafts. Again, if this were spent within the country, the deposits and cash reserves of the banks receiving the cheques would be increased by £800,000, against which they could increase their lending by £640,000. Already, therefore, deposits have increased by £1 million plus £800,000 plus £640,000 and advances by £1 million plus £800,000 plus £640,000 on the basis of the initial excess cash reserve of £1 million, although no one bank after the first has ever lent out more than four-fifths of any addition to its excess cash reserves. The process would continue until advances and deposits had increased by £5 million. Then the banking system as a whole would have no further excess reserves of cash – the excess £1 million with which it started would all be required as the 20 per cent reserve against its increased deposits of £5 million.

70. This example is, of course, over-simplified. In practice, for instance, the banking system could not expand its lending as far as this, because some of the additional cash would probably be withdrawn by the public, wanting to hold more notes in circulation, and some might have to be used to buy overseas exchange from the Reserve Bank to satisfy an increased demand for imports. But it illustrates the proposition that, while no individual bank, by itself, can engage in a multiple expansion of credit, the banking system as a whole can do so through the process of transferring excess reserves of bankers' cash from one bank to another.

71. It should be noted that the converse also applies. If the cash reserves of the banks are reduced, and they were previously lending to the maximum, their deposits will have to be reduced, in the absence of intervention by the Reserve Bank or Government, by a multiple of the reduction in their cash reserves, as they attempt to regain the required ratio between bankers' cash and deposits.

72. Since the deposits are money, it is clear that this process of creation and destruction of bank deposits must be closely controlled in the public interest.

(v) *Have the Trading Banks Usurped the Community's Credit?*

73. Miss King, in her submissions for the New Zealand Social Credit Association, and several other witnesses complained that the trading banks had usurped the community's credit. Miss King correctly pointed out that the possession of money gave power-of-demand over goods and services; and she urged that the amount issued should be a faithful reflection of the *"known capacity"* of the community *"to produce and deliver goods and services"*. She complained, however, that the trading banks issued money in the form of loans, and thus apparently presumed that the money was their own property; in fact, it was the property of the community as a whole – *"the reflection or monetisation of the Real Credit or Productive Capacity of the Nation"*. The *"claim* (of the banking system) *to own the credit it deals in"* was, she felt, *"the usurpation of the most important and powerful social asset the community possesses"*. What was needed in her view was the issue of free money, to avoid increasing burdens of debt; but this was impossible *"unless the beneficial ownership of financial credit"* was *"vested in the community"*.

74. We have seen that, to lend on any scale, the banks must induce a large number of depositors to leave money with them. When a depositor leaves money with a bank, the funds he pays in become the property of the bank; and the bank is, in our view, as entitled as any other owner of money to charge interest on any loans which are made on the basis of those funds. In return for the use of the funds, the banker undertakes certain obligations to the depositor. First, he is under an obligation to pay the depositor or his nominee notes and coin either on demand, or, in respect of a fixed deposit, after a stipulated period. His ability to honour this obligation would be gravely endangered if he gave money away instead of lending it (and, incidentally, it is easy to imagine his difficulties in choosing among the applicants for the money). Secondly, to those with sums on fixed deposit he must pay interest and to those with current account deposits he must provide relatively costly chequing facilities and other bank services. To pay this interest and provide these services, he must get income from somewhere. Today he gets most of it by charging interest on loans to people who want to borrow and are prepared to pay the interest for the use of the money. He could perhaps charge depositors more for the chequing services he provides and lend at lower rates of interest; but then he would probably have less to lend, because some people and firms would stop using the bank as a repository, keep more cash in hand, and make their payments in notes and coin instead of by cheque. The provision of bank money would, in any case, cost the community just as much as before, unless the banks' profits were reduced. The only difference would be that it would be the depositors, not the borrowers, who bore the main burden of the cost.

75. In fact, the only cost of providing bank money which the community could avoid by taking over the *"beneficial ownership of financial credit"* would be some part of the profits made by the private banks. But it was clear that most witnesses who spoke in this vein did not want to see the trading banks nationalised; nor did they envisage the abolition of interest on the provision of loans by the trading banks. This appears to us to show the weakness of their argument about the usurpation of the community's credit.

76. Several witnesses advocated the provision of substantial amounts of interest-free, non-repayable advances to the Government. This could be done today through the Reserve Bank, if it were thought to be desirable. Of course, the contribution of the Reserve Bank to the Consolidated Fund would then fall and, perhaps, some of its expenses would have to be met by the Government in other ways. Whether issues of "debt-free money" of this kind are desirable is considered in our analysis of the Social Credit submissions.

77. In fact, as we have indicated above, the Government today has a wide range of weapons to enable it to control the issue of money in the interest of the community. The community, through its elected representatives, therefore, already has power to ensure that sufficient money and no more than sufficient money is issued to enable the best use to be made of the country's labour and material resources. Whether this power has been exercised wisely in recent years is examined in Section Seven of our report.

Section Two: The Monetary and Banking System

I. INTRODUCTION

78. As the following table shows, the volume of money in New Zealand, as defined by the Reserve Bank, rose from £46 million at the end of June 1935 to £317 million at the end of June 1955, an increase of £271 million, or about 600 per cent. If unexercised overdraft authorities are included, the total rose from £77 million in 1939 to £417 million in 1955.

Volume of Money Together with Unexercised Overdraft Authorities 1935 to 1955

(£ million)

—	Last Balance Day in June								
	1935	1939	1943	1945	1949	1951	1952	1954	1955
Coin in circulation	0·9	1·4	2·3	2·7	3·2	3·6	3·8	4·1	4·3
Notes held by public ..	6·1	11·5	27·5	34·5	42·3	48·4	50·1	57·1	59·0
Demand deposits at—									
Reserve bank	13·3	2·5	23·7	15·3	8·1	13·5	12·0	10·5	15·1
Trading banks	25·9	37·3	79·0	96·9	153·6	211·9	192·2	240·6	238·6
Total (Reserve Bank def.)	46·2	52·7	132·5	149·4	207·2	277·4	258·0	312·3	317·0
Unexercised overdraft authorities	(1)	24·0	36·2	38·8	58·7	76·4	68·8	111·7	100·1
Total (including unexercised overdraft authorities)	(1)	76·7	168·7	188·2	265·9	353·8	326·8	424·0	417·1

(1) Not available.

79. The most important part of the supply of money is that held by customers of the trading banks in their current accounts. In addition, customers of the banks have available for spending substantial amounts in the form of unexercised authorities to overdraw their accounts. We suggest in Section Four of our report that these should be taken into account in future in statistics showing changes in the volume of money. However, to avoid confusion and to make the analysis in this report comparable with earlier publications, we have adhered to the Reserve Bank definition of money in the following discussion.

II. CAUSES OF CHANGES IN THE VOLUME OF MONEY: GENERAL

80. The main causes of changes in the volume of money during the periods we have selected are shown in the following table:

Causes of Change in the Volume of Money
(£ million)

Years ended June	Total Change	Overseas Trans-actions	Government Borrowing from Banks	Trading-bank Advances and Discounts	Shifts in Wool Retention Accounts	Other
1935–39 ..	+ 6·5	−36·5	+17·0	+ 9·9	..	+16·1
1939–43 ..	+ 79·8	+33·8	+56·2	− 13·1	..	+ 2·8
1943–45 ..	+ 16·9	+39·3	−24·8	+ 10·6	..	− 8·1
1939–45 ..	+ 96·7	+73·1	+31·4	− 2·5	..	− 5·3
1945–49 ..	+ 57·8	+16·8	+ 6·7	+ 27·5	..	+ 6·8
1949–51 ..	+ 70·2	+43·3	−14·5	+ 52·7	−20·9	+ 9·6
1951–52 ..	− 19·3	−48·7	− 6·0	+ 40·3	− 7·8	+ 2·9
1952–54 ..	+ 54·3	+64·6	− 7·6	− 23·6	+12·0	+ 8·9
1954–55 ..	+ 4·6	−35·5	− 7·5	+ 34·8	+ 5·8	+ 7·0
1949–55 ..	+109·8	+23·6	−35·6	+104·2	−10·9	+28·4
1934–55 ..	+270·8	+77·0	+19·5	+139·1	−10·9	+46·0

81. It is convenient to discuss these changes in the volume of money and their causes in four main periods.

1935 to 1939

82. During this period the volume of money increased relatively slowly (by only £6·5 million). As the country emerged from the depression, and the value and volume of production and trade increased, more trading-bank credit was required. By the middle of 1939, despite the fact that the Reserve Bank took over the finance of the marketing of dairy produce and of certain other primary products handled by the new Marketing Department, trading-bank advances and discounts had risen to nearly £10 million above the June 1935 figure. The Reserve Bank's advances for marketing purposes increased to over £6 million by the middle of 1939, partly because it was at first necessary to pay out to farmers under the guaranteed price scheme for dairy produce more than was received from the sale of the produce overseas. The Government also borrowed from the banking system. Up till the middle of 1938, it had increased its borrowing by only about £2½ million, but in 1938–39 its indebtedness to the banks rose by nearly £15 million. The effect of this expansion of bank credit on the volume of money was largely offset by a gradually increasing deficit in the balance of payments, as traders began to spend more freely on imports and others remitted some of their capital from the country.

1939 to 1945

83. By the middle of 1943, the volume of money was nearly two and a half times as great as it had been in June 1939. The major cause was a heavy increase (£56 million) in borrowing by the Government from the banking system. In addition, rising export receipts and shortage of imports produced annual surpluses in the balance of payments, adding about £34 million to the volume of money by June 1943. On the other hand, trading-bank advances declined by £13 million with the curtailment due to the war of many activities which the banks had customarily financed.

84. From mid-1943 to mid-1945, the Government reduced its indebtedness to the banking system by £25 million. Despite this, the volume of money increased by £17 million during these two years, primarily due to surpluses totalling £39 million in the balance of payments. But the rate of increase had declined considerably from that prevailing in the early years of the war, and this must have contributed markedly to the success of the Government's stabilisation policy.

1945 to 1949

85. Over this period the volume of money increased by £58 million. £27 million of this increase occurred in the June year 1945–46, mainly due to a surplus of £20 million in the balance of payments. Between June 1946 and June 1948, as the economy began to return to its peacetime shape, advances and discounts rose by £32 million; the effect on the volume of money of this increase was offset to some extent by the Government reducing its indebtedness to the banking system by about £10 million, and by a deficit of £3 million in the balance of payments in the same period. However, in 1948–49, after the appreciation of the exchange rate, conditions in the money market tightened, and the annual accretion to the farm stabilisation accounts was substantially reduced, so that the Government received less than before from these accounts and from the savings banks to finance its works programme. It met the situation by increasing its borrowing from the Reserve Bank by £11 million. This was the major cause of the rise of £13 million in the volume of money in that year.

1949 to 1955

86. Between 1949 and 1951, the volume of money rose by £70 million. The wool boom brought a large surplus in the balance of payments (£43 million), and this was accompanied by a steep increase in bank advances (£53 million). Buoyant tax receipts, on the other hand, enabled the Government to implement its declared policy of reducing its debt to the banking system, which it did by £15 million, and up to June 1951, £21 million was withdrawn from circulation temporarily by the wool retention scheme. But overall there was a sharp increase in the purchasing power available to the people.

87. In 1951–52 there was a spectacular increase in the value of imports, as traders attempted to cater for the greatly increased demand of the public. This led to a deficit of £49 million in the balance of payments for the year as compared with a surplus of £36 million in the previous year. The effect of this deficit on the volume of money was to a large extent offset by an associated rise of £40 million in the total of advances.

But a further reduction of £6 million in the Government's debt to the banking system, and the freezing of a further £8 million under the wool retention scheme, contributed to a total reduction in the supply of money of £19 million – the first reduction in a June year since 1937–38.

88. However, the supply of money rose sharply again (by £54 million) in the two following years. Exchange allocations had been introduced and many traders found they had overestimated the extent of the immediate market for their goods. As a result, imports fell from the unusually high level they had reached in 1951–52. With buoyant export receipts, a surplus of £65 million was achieved in the balance of payments for the period of two years ended June 1954. The wool growers also began to make withdrawals from their wool retention accounts and received £12 million in the two years. On the other hand, bank advances fell during this period by £24 million. They were reduced by £45 million in 1952–53 and rose by £21 million in the subsequent year. An increase of £16 million in the Government's borrowing from the banking system in 1952–53 was more than offset by a decrease of £23 million in 1953–54. But overall, the supply of money had been expanded by £54 million in the two years.

89. With this expansion accompanying the relaxation and later removal of exchange allocation the country again experienced a large deficit in its balance of payments in 1954–55 (£36 million). The Government also reduced its debt to the banking system by £7½ million. But despite these factors, the volume of money still increased by £5 million in the year; bank advances continued to increase sharply (by £35 million); wool growers withdrew a further £6 million from their retention accounts; and marketing advances by the Reserve Bank increased substantially owing to the return to free marketing and some delay in the disposal of dairy produce.

Summary, 1935 to 1955

90. Just over one-half of the increase of £271 million in the volume of money between June 1935 and June 1955 was ascribed to increases of £139 million in trading-bank advances and discounts. The second most important factor was the surplus in overseas transactions during the period, which expanded the money supply by £77 million or 28 per cent of the increase. However, it is necessary to be cautious in the use of these figures. First, when the level of bank credit and the balance of payments are fluctuating markedly, as they have been particularly since 1950, the passing of one year may make a considerable difference to the picture. For instance, if we exclude the year 1954–55, and examine the causes of the rise in the volume of money between June 1935 and June 1954, we find that the surplus in external transactions is responsible for 42 per cent and the rise in trading-bank advances for only 39 per cent of the increase. Secondly, some of the items mentioned as separate causes of the changes in the volume of money are inter-related. For example, a rise in the level of advances may be partly an effect of a rise in the level of imports, to finance which traders require extra bank accommodation. The rise in imports in turn gives rise to a deficit in the balance of payments. We must, therefore, look more closely at the reasons for the changes in the major items which have influenced the volume of money during the period.

III. MAJOR CAUSES OF CHANGES IN THE VOLUME OF MONEY

(a) GOVERNMENT BORROWING FROM THE BANKING SYSTEM

91. It can be seen from the table in paragraph 80 above that only £19·5 million of the increase of £271 million in the volume of money which took place between June 1935 and June 1955 can be attributed to Government borrowing from the banking system. The choice of the end of June as our date for comparison is, however, a little misleading in this case for, in the past two years, the Government's debt to the banking system has been unusually low at the end of June in relation to its average debt during the year. A better indication of the changes which have taken place is given in the table below, which shows annual averages of the Government's indebtedness to the banking system:

Government Indebtedness to the Banking System

(£ million)

Calendar Year	Reserve Bank Investments in New Zealand (1)	Reserve Bank Holdings of Treasury Bills (2)	Total Borrowing from Reserve Bank	Trading-bank Investments in Government Securities (2)	Total Borrowing from Banking System	Public Account Balance with Reserve Bank (2)	Net Indebtedness to Banking System
1935	1·5	..	1·5	(3)	(3)	3·8	(3)
1936	1·5	0·3	1·8	5·2	7·0	2·6	4·4
1937	2·4	0·7	3·1	7·6	10·7	4·0	6·7
1938	2·1	3·3	5·4	7·6	13·0	2·4	10·6
1939	2·1	14·0	16·1	11·3	27·4	1·1	26·3
1940	2·6	22·0	24·6	16·5	41·1	2·7	38·4
1941	2·6	17·2	19·8	20·3	40·1	4·6	35·5
1942	3·0	23·3	26·3	27·2	53·5	7·4	46·1
1943	8·4	33·5	41·9	36·1	78·0	8·2	69·8
1944	9·6	34·3	43·9	36·1	80·0	5·7	74·3
1945	7·5	24·1	31·6	29·3	60·9	3·6	57·3
1946	1·7	35·4	37·1	26·2	63·3	3·9	59·4
1947	0·7	28·9	29·6	20·9	50·5	1·6	48·9
1948	4·8	35·3	40·1	17·0	57·1	1·5	55·6
1949	34·7	37·2	71·9	12·9	84·8	1·0	83·8
1950	26·9	52·2	79·1	11·7	90·8	3·2	87·6
1951	17·1	50·5	67·6	11·7	79·3	3·4	75·9
1952	11·3	50·0	61·3	11·7	73·0	2·8	70·2
1953	20·5	50·0	70·5	11·7	82·2	−2·2	84·4
1954	9·3	36·7	46·0	23·0 (4)	69·0 (4)	1·7	67·3 (4)
1955	10·7	32·7	43·3	23·1 (5)	66·4 (5)	2·3	64·1 (5)

(1) Average of monthly figures up to 1945: Average of weekly figures thereafter.
(2) Average of monthly figures.
(3) Not available.
(4) Includes £11 million of State Advances Corporation stock.
(5) Includes £11·5 million of State Advances Corporation stock.

92. The major feature which emerges from this table is that the Government's debt to the banking system has not fallen as greatly in the past six years as the end of June figures suggest. If we studied changes in the average of the volume of money over the twelve months of a calendar year, the increase in the volume of money would be greater and the contribution of Government borrowing to the increase which has taken place since 1935 would be found to be in the vicinity of £40 million.

93. The Government borrows from the banking system when the total of the money it receives from taxation, loans, and other non-banking sources proves insufficient to finance its total expenditure. It is unwise to attach too much significance to changes from one year to another, because an increase in debt to the banking system may merely reflect temporary recourse by the Government to what really amounts to

overdraft accommodation due to an unexpectedly slow inflow of tax or loan moneys. For instance, part of the increase in the Government's borrowing in 1949 may be ascribed to a rather sudden drying up of sources, such as Post Office Savings Bank and the farm stabilisation accounts, upon which it had come to rely for a substantial contribution towards its capital works programme. Nevertheless, if there were a persistent rise in indebtedness to the banking system, it would suggest that the Government was adopting a deliberate policy of financing a portion of its expenditure by inflating the money supply, rather than by taxation or by borrowing part of the existing supply of money.

94. The Government may inflate the money supply either by borrowing from the trading banks or by borrowing from the Reserve Bank. There is an important difference, however, between the two methods of inflation. When the Government borrows from a trading bank, the bank gives it a cheque in return for an interest-earning Government security. The cheque is deposited by the Government in the Reserve Bank, which takes payment from the trading bank by deducting the amount from the bank's balance at the Reserve Bank. The initial effect, therefore, is to increase Government deposits (which are money) and reduce bankers' deposits at the Reserve Bank. When the Government spends the money, the cheques which it issues are likely to be lodged by the recipients with their trading banks, thus increasing total deposits there. When the trading banks present the cheques to the Reserve Bank for payment, they regain as a group the balances at the Reserve Bank which they lost when they paid for the Government securities. The effect of the transaction is to increase customers' deposits at the trading banks while the total reserves of the banks are restored to their original level. Since the ratio between the reserves of the banks and their customers' deposits has declined, their ability to lend further has been somewhat reduced. The above assumes that none of the money borrowed is spent on imports or kept in circulation as notes and coin by the public. If it were so spent, the banks' ability to expand their lending would be even more significantly reduced.

95. The immediate effect of Government borrowing from the Reserve Bank is similar to the effect of borrowing from a trading bank. The Reserve Bank gives the Government a deposit (which is money) in return for an interest-earning Government security. When the Government spends the money, the people receiving the cheques pay them into their trading banks, thus increasing customers' deposits there. The banks present the cheques to the Reserve Bank for payment and are credited with the amounts concerned in their accounts at the Bank. Thus their reserve balances at the Reserve Bank and the ratio between these balances and their customers' deposits are increased. Their ability to lend is improved, provided there is no increase in the reserve ratio requirement or in the severity of other controls on their lending. And, as we have seen, the ultimate effect of an addition to their reserves, if they can find borrowers, is a multiple expansion of their customers' deposits and, therefore, of the supply of money. The extent of the expansion will depend on the ratio which they must preserve between reserves and deposits. Thus Government borrowing from the Reserve Bank is potentially more inflationary than borrowing from the trading banks. The practical importance of increases in Reserve Bank lending to the Government is for this reason considerably greater than appears

from tables showing causes of changes in the volume of money, for these record only the initial impact of the changes in Reserve Bank credit. But part of the increase in the volume of money which is attributed to trading-bank advances has been made possible only because greater Reserve Bank lending has increased the banks' reserves and, therefore, their ability to lend.

96. There have been important changes in Government policy towards borrowing from the trading banks during the period considered. Up till 1943, it was normal practice for the trading banks to invest in Government loans, and from 1936 to 1943 their investments in Government securities rose from £5·2 million to £36·1 million. As from 1943, the Government decided not to permit the trading banks to subscribe to Government loans and repaid their existing securities as they matured. As a result of this policy and as shown by the table in paragraph 91, the banks' holdings of Government securities had fallen to £11·7 million by 1950, a figure very little above that ruling in 1939.

97. The new Government continued the policy of preventing the banks from subscribing to Government loans, but permitted them to maintain their existing holdings at about £11·7 million. Apart from a temporary investment of £0·5 million by one of the banks in 1954, there has been only one departure from this policy since 1950. In January and March 1954, the banks were invited to invest a total of £12 million in State Advances Corporation stock to assist in financing the Government's housing programme. Later we shall discuss the desirability of such a course at a time when labour and resources are fully employed.

98. The Government may borrow from the Reserve Bank in three ways:

(a) It may sell the Bank long-term securities;
(b) It may issue to the bank Treasury bills which mature in three months' time;
(c) It may obtain an overdraft at the bank.

99. The extent to which the Government may borrow on overdraft from the Reserve Bank or issue Treasury bills to the bank is limited by the Reserve Bank Act. Borrowing on overdraft is limited to the extent that the amount owing at any time during any financial year must not exceed one-quarter of the total revenue of the preceding year; and in that the amount owing at the end of any financial year must not exceed the total revenue of that year which remains outstanding and unpaid and is properly payable into the Public Account. (Section 35 of Public Revenues Act 1953.)

100. The Bank is also not permitted to:

> grant accommodation, either directly or indirectly, to the Treasury, or to any incorporated Department of State . . . by way of discounts, loans, advances, overdrafts, or otherwise, in excess of the revenue or estimated revenue for the year in the case of the Treasury, or one-fourth of their respective revenues or estimated revenues for the year in the case of any other Department of State. (Section 14 (i) of Reserve Bank of New Zealand Act 1933.)

101. However, these limitations are ineffective because there is no limitation on the power of the Government to borrow by selling long-term securities to the bank. The practical effect of all three methods is the same and, at present, the State pays 1 per cent for all three types of accommodation.

102. The Government had little recourse to Reserve Bank credit up till 1938, when its total borrowing from the Bank was about £5½ million. The Government indicated in its 1939 Financial Statement that it realised that New Zealand at the time was *"not suffering from a shortage of money, but from a shortage of what money will buy"*; but its indebtedness to the Reserve Bank increased by £10·7 million in the calendar year 1939 as compared with 1938. Likewise, in the Financial Statements for 1940, 1942, and 1943, it was stressed that it was *"infinitely better for everybody that the measure of the sacrifice required from each and every one to carry on the war should be made out of our current income"; ". . . to proceed on the principle of pay as we go"*; because *"creation of credit takes away by unseen methods the value of work done and savings made and ultimately in the form of price increases hits those most who have to spend their incomes on necessaries of life"*. However, the Government apparently felt forced in the circumstances to borrow further from the bank, mainly by issuing Treasury bills, and by 1944 total Government borrowing from the Reserve Bank had reached £44 million. Most of the borrowing was attributed specifically to its housing programme, and some to its public works programme; little was attributed to war purposes.

103. As indicated earlier, the Government set its face against reliance on bank credit after 1943. Its record of war finance, as a consequence, compares favourably in this respect with that of any other country. By 1947 it had reduced its debt to the Reserve Bank to £30 million. However, this reduction was more than offset in the next two years and, by 1950, the level of Government borrowing from the Reserve Bank was nearly £50 million greater than in 1947. £20 million of the increase resulted from an issue of Government securities to the Reserve Bank in compensation for a loss which the Bank incurred on its holdings of foreign exchange as a result of the appreciation of the exchange rate in 1948. This merely provided the bank with an interest-bearing security and did not add to the volume of money in New Zealand. The bulk of the remainder of the increase took place in the financial year 1949–50 when the Government increased its net indebtedness to the bank by over £18 million. As mentioned earlier, this was used to finance part of the Government's works programme due to a shortage of investment money after the exchange adjustment of 1948.

104. Since 1950 the declared policy of the Government has been to reduce its indebtedness to the Reserve Bank. Buoyant revenues enabled the debt to be reduced from £79 million in 1950 to £61 million in 1952. However, after a substantial deficit in the balance of payments, the money market became tight in 1952 and, in an endeavour to relieve pressure on the limited funds available and to avoid a rise in rates of interest, the Government decided not to raise a public loan during the year ending March 1953. To finance its expenditure it used Reserve Bank credit, and drew on accumulated balances in the Public Account. As a result, the Reserve Bank's holdings of Treasury bills and Government stock rose again to a level of nearly £71 million in the calendar year 1953. However, the downward trend was resumed from 1953 onwards, and the average indebtedness of the Government to the Reserve Bank in 1955 was about £43 million.

105. Looking at Government borrowing from the banking system as a whole, the greatest increase (from £13 million to £80 million) took place between 1938 and 1944. Between 1944 and 1947, £30 million was repaid, but in the next three years, despite a reduction of £9 million in debt to the trading banks, total debt to the system rose by £40 million. (This includes the £20 million of securities issued to the Reserve Bank on account of the exchange adjustment.) Since then, with the exception of 1952–53, the Government's indebtedness has been consistently reduced and in 1955, at £66 million, stands about £25 million below the 1950 total.

(b) OTHER RESERVE BANK ADVANCES

106. The table on page 265 shows the changes which have taken place in the various assets of the Reserve Bank since 1936.

107. The table reflects the fact that the Reserve Bank lends money to the Government, to certain marketing organisations, and to the trading banks when they require loans to help meet reserve ratio requirements.

108. In 1936 the Government set up a Primary Products Marketing Department, with an Internal Marketing Division which took over the marketing of eggs, fruit, and honey, and an External Marketing Division, which handled all exports of dairy produce. During the war the Department was also given responsibility for marketing meat and wool and several other minor products. Thus the Reserve Bank took over the financing of many marketing activities previously catered for by the trading banks; and, incidentally acquired a large amount of sterling from the sale of exports which would normally have been acquired by the trading banks.

109. In 1946, wool marketing returned to its normal channels and was no longer financed by the Reserve Bank. However, when the marketing of dairy produce and meat was handed over during the next two years to the Dairy Products Marketing Commission and the Meat Producers' Board respectively, these bodies continued to receive overdraft accommodation from the Reserve Bank. With the termination of the bulk purchase contract for meat in September 1954, the trading banks once again resumed full responsibility for financing meat marketing, but the Reserve Bank still acts as the banker of the Dairy Products Marketing Commission and the organisations concerned with the marketing of apples and pears, citrus fruits, honey, eggs, and milk. The Dairy Products Marketing Commission and these other organisations retain the privilege of obtaining overdraft accommodation at 1 per cent per annum.

110. The distinction between Reserve Bank and trading-bank financing of the marketing of produce is similar to that between Reserve Bank and trading-bank financing of the operations of Government. Reserve Bank advances are potentially more inflationary in that they add to the reserves of the trading banks and thus, in the absence of offsetting movements of the reserve ratios, make possible a multiple expansion of trading-bank credit.

111. The Reserve Bank's "other advances and discounts" included until 1951 only the drawings on credits granted by the Government to France (£5 million) in 1947 and to Czeshoslovakia (£1 million) in 1948 to buy New Zealand wool. The Czechoslovakian loan was repaid in

Assets of the Reserve Bank: Weekly Average for Calendar Year

(£ million)

Year	Reserve: Gold (at Cost)	Reserve: Exchange (¹)	Subsidiary Coin	All Marketing Advances	Advances to State for Other Purposes	Other Advances and Discounts: Trading Banks	Other Advances and Discounts: Other	Investments: In New Zealand	Investments: Overseas	Other Assets	Total Assets
1936	2·8	20·8	0·2		1·3	..	..	1·5	0·5	0·1	27·2
1939	2·8	5·3	0·2	6·1	13·6	..	..	2·1	1·6	0·2	31·9
1942	2·8	22·5	..	6·8	23·1	..	..	3·0	1·2	1·5	60·9
1945	2·8	60·1	..	2·1	24·2	..	..	7·5	4·3	1·5	102·4
1948	2·8	65·1	0·1	1·7	35·2	..	2·4	4·8	5·7	7·5	125·4
1950	4·3	51·6	0·2	5·1	52·2	..	5·4	26·9	4·4	2·3	152·3
1951	5·1	62·9	0·5	3·4	51·1	0·8	6·0	17·1	10·0	3·2	160·2
1952	5·9	24·7	0·6	2·3	50·8	0·1	6·0	11·3	30·2	1·8	133·6
1953	6·0	59·1	0·6	4·8	53·2	..	6·0	20·5	23·0	1·0	174·2
1954	6·1	74·9	0·6	6·7	38·4	3·4	5·5	9·3	23·6	0·9	169·5
1955	6·2	46·7	0·6	17·4	35·6	5·9	5·0	10·7	23·0	0·9	152·3

(¹) Prior to 1950, the figures cover sterling exchange only: thereafter they include "Other Exchange" formerly shown under "Other Assets".

May 1954, and the French loan falls due for repayment in December 1957. The effects of such loans are equivalent to an increase of similar amount in marketing advances.

112. It was not until 1951 that the Reserve Bank was called upon, for the first time, to lend to the trading banks. The extent of trading-bank borrowing is examined in more detail later when we consider the Reserve Bank's credit control policy, but it can be seen from the table on page 265 that, on the average of weekly figures for the calendar year, the trading banks were in debt to the extent of £800,000 in 1951 and of £100,000 in 1952; that they had no need to borrow in 1953; and that their debt to the bank rose to a weekly average of £3·4 million in 1954 and £5·9 million in 1955. A trading bank borrows from the Reserve Bank when the ratio between its balances at the bank and its customers' deposits falls below the reserve ratio minimum requirement. The borrowing of £1 million from the Reserve Bank, of course, adds that amount to its basic reserves. The fact that the Reserve Bank is prepared to lend to the trading banks in this way does not directly increase the volume of money, but enables the banks to avoid the necessity of rapidly calling in loans or selling investments, of a value several times the shortage in their basic reserves, in order to meet the statutory reserve ratio. The Reserve Bank decides the rate of interest at which it will lend to the banks.

(c) TRADING-BANK CREDIT

113. The following table gives an indication of the outlets which have been available for the funds of the trading banks during the period under review:

Trading-banks' Assets: Monthly Average for Calendar Year

(£ million)

Year	Coin and Bullion	Reserve Bank Notes	Balances Held in Reserve Bank	Gross Overseas Assets	Securities Held: Government	Securities Held: Other	Advances and Discounts	Land, Buildings, etc.	Total Assets
1935 ..	0·8	3·6	5·3	21·9	(1)	(1)	45·9	(1)	(1)
1939 ..	0·7	3·9	11·1	6·7	11·3	0·3	54·2	1·9	90·1
1943 ..	0·6	4·6	27·7	11·9	36·1	1·6	43·0	1·9	127·4
1946 ..	0·7	7·0	60·2	14·0	26·2	2·3	58·3	2·0	170·5
1949 ..	1·5	8·7	75·9	22·0	12·9	1·8	82·0	2·3	207·1
1950 ..	1·7	9·8	75·2	24·8	11·7	1·7	94·1	2·6	221·5
1951 ..	1·5	11·5	70·3	37·3	11·7	1·5	133·1	3·1	270·0
1952 ..	1·5	11·1	51·1	26·6	11·7	1·3	166·6	3·6	273·5
1953 ..	1·5	10·6	93·1	25·6	11·7	2·3	134·5	4·1	283·4
1954 ..	1·4	11·1	79·4	26·0	12·0	13·2 (2)	154·8	4·5	302·3
1955 ..	1·4	10·2	56·9	11·7	11·6	13·6 (3)	180·0	5·3	306·6

(1) Not available.
(2) Includes £11 million of State Advances Corporation stock.
(3) Includes £11·5 million of State Advances Corporation stock.

114. The banks' investments (other than those in Government securities already discussed) are small and mainly in local body securities. Holdings of such investments rose from £300,000 in the late 1930's to £2½ million in 1944–45, after which they slowly declined to £1·3 million in 1952. They increased to £2·3 million in 1953 and have since remained at about that total.

115. The New Zealand trading-banks' total holdings of securities comprise a much lower percentage of their deposits than is the case in most other countries. The ratio of securities to total deposits was 8·2 per cent in 1935 and rose gradually to 35 per cent in 1943. As a result of the change of Government policy as regards bank purchases of Government stock, and of the large increase in deposit liabilities, this ratio fell to 5·1 per cent by 1952, since when it has risen to 8·7 per cent as a result of the purchase of State Advances stock.

116. In the light of their relatively low holding of securities, and in the absence of any short-term money market which would enable the banks to invest in commercial or Treasury bills as can banks in countries with more fully developed money markets, the New Zealand trading banks must rely heavily on advances to customers in order to earn revenue. This can be seen from the figure for advances and discounts in the table above. (Discounts are a negligible proportion ($2\frac{1}{2}$ per cent in March 1955) of the total advances and discounts.)

117. We indicated in the previous section that trading-bank advances had been responsible for £139 million or just over one-half of the total increase in the volume of money of £271 million between June 1935 and June 1955. The following table shows that the bulk of the increase in trading-bank advances has taken place since 1949:

Year Ended June	Change in Trading-Bank Advances and Discounts (£ million)	
1935 to 1939	+ 9·9	
1939 to 1943	− 13·0	+ 34·9
1943 to 1945	+ 10·5	
1945 to 1949	+ 27·5	
1949 to 1951	+ 52·7	
1951 to 1952	+ 40·3	+104·2
1952 to 1954	− 23·6	
1954 to 1955	+ 34·8	
	+£139·1	

The Period from 1935 to 1949

118. The question arises why trading-bank advances were responsible for only £35 million or 22 per cent of the increase of £161 million in the volume of money between June 1935 and June 1949. We have seen that the extent to which trading banks can lend depends on these factors:

(i) The ratio which the banks' basic reserves bear to their deposit liabilities to customers.

(ii) The ratio which they are required to keep between their balances at the Reserve Bank and their deposit liabilities and the rate of interest charged by the Reserve Bank for loans to the trading banks.

(iii) The tightness of any other controls by Government or Reserve Bank over their lending.

(iv) The availability or credit-worthy borrowers wanting bank advances at the ruling rates of interest.

We discuss these matters in turn in relation to the banks' lending between 1935 and 1949.

(i) *The Ratio Between Basic Reserves and Deposit Liabilities*

119. It is well known that the major banks in the United Kingdom aim, if possible, to maintain a ratio of about 8 per cent between their cash (i.e., their notes, coin, and balances at the Bank of England) and their customers' deposits; and a ratio of about 30 per cent between their liquid assets (i.e., their cash plus their loans to discount houses and holdings of Treasury and commercial bills) and their customers' deposits. As far as we could ascertain, the New Zealand banks do not work to any similar rules. Naturally, in the absence of any short-term money market offering facilities for investment of money at call or very short notice, New Zealand banks must for safety hold a much larger proportion of their assets in the form of bankers' cash than their British counterparts. Mr Whyte, Chairman of the Associated Banks, expressed the personal view that, given holdings of securities similar to those held by the banks early in 1955, trading banks should aim at having bankers' cash at about 20 to 25 per cent of their deposit liabilities. However, as indicated in the table below and in the more detailed table in Appendix H, there has been no consistency in the ratio between bankers' cash and deposits in the period which we are discussing, and for the bulk of the period this ratio has been considerably above the level cited by Mr Whyte.

Proportions Between Selected Assets of the Trading Banks and Their Customers' Deposits, 1935 to 1949

Average of Monthly Figures for Calendar Year	Bankers' Cash([1]) to Total Deposits	Bankers' Cash([1]) Plus Net Overseas Assets to Total Deposits	Securities to Total Deposits	Advances and Discounts to Total Deposits
	Per Cent	Per Cent	Per Cent	Per Cent
1935 ..	15·5	48·7	8·2	73·7
1938 ..	17·5	28·2	12·0	85·1
1943 ..	30·6	41·0	35·0	40·0
1946 ..	44·8	53·0	18·8	38·5
1949 ..	45·4	53·1	7·7	43·2

([1]) Bankers' cash includes notes and coin and balances at the Reserve Bank of New Zealand.

120. The ratio of bankers' cash to deposits may appear to have been low, at 15·5 per cent, in 1935, but this must be considered in conjunction with the relatively large amounts of foreign exchange held by the banks at that time. Had they wished they could readily have converted a fair proportion of these into balances at the Reserve Bank. Together, cash and net overseas assets were equal to nearly 49 per cent of the banks' deposit liabilities, which is a very "liquid" position. The next three years, however, saw a progressive decline in this ratio, until it reached 28 per cent in 1938. This was mainly a reflection of the substantial deficits in the balance of payments experienced in this period which reduced the banks' net overseas assets by nearly £14 million. In the same period (1936 to 1938) advances increased by only £10 million and deposits by £3½ million. In 1938 the banks must have been very close to what they would consider a prudent minimum level of reserves.

121. The period from 1938 to 1946 saw very considerable increases in the cash reserves and to some extent in the net overseas assets of the trading banks. Their balances at the Reserve Bank rose from £6·7 million to £60·2 million; their net overseas assets from £7 million to £12·6 million. The major cause of the rises was the continued surpluses in the balance of payments noted above. Much of the excess sterling from these surpluses was deposited with the Reserve Bank by the marketing authorities; but when the New Zealand equivalent of these funds was paid out to producers, or lent to the Government through investment in Government securities of the primary industry reserve accounts, the cheques drawn on the Reserve Bank eventually came into the hands of the trading banks. Their balances at the Reserve Bank were in turn built up when they presented these cheques for payment. During the same period, the Government borrowed quite heavily from the Reserve Bank and this added further to the cash reserves of the trading banks. By 1946, the ratio of cash to deposits was 45 per cent and the ratio of bankers' cash and net overseas assets to deposits 53 per cent. During the whole of the war, advances and discounts remained below the levels they had reached in 1938, and in 1946 were only £2·4 million above the 1938 level. It is clear, however, that trading-bank advances were not prevented from expanding by any shortage in reserves of bankers' cash or net overseas assets.

122. Advances rose by about £24 million between 1946 and 1949, but this was offset to some extent by a fall of £14 million in investments. Continued surpluses in the balance of payments and further Government borrowing from the Reserve Bank built up cash reserves and net overseas assets sufficiently to maintain the ratios between these items and total deposits in 1949 at figures comparable with those ruling in 1946.

123. Over the whole period 1935 to 1949, the banks' holdings of bankers' cash and net overseas assets rose by £70 million, but bank advances rose by only about £36 million and securities by about £10 million. Thus there was no multiple expansion of bank credit on the basis of the increased reserves; in fact, the banks expanded their lending by an amount equivalent to only two-thirds of their increased holdings of cash and overseas funds.

(ii) *The Statutory Minimum Reserve Ratios*

124. No shortage of reserves, therefore, prevented a substantial expansion of bank credit during this period. Nor did the statutory reserve ratios do so. The minimum balances required to be kept at the Reserve Bank remained throughout at 7 per cent of demand liabilities and 3 per cent of time liabilities respectively. The actual ratio maintained by the banks was always well above these figures.

(iii) *Other Controls on Advances*

125. As mentioned previously, a selective advance control policy, administered by the Reserve Bank, was in operation from January 1942 onwards. No statutory regulations were introduced, and in its administration of the policy the Reserve Bank relied on the voluntary co-operation of the trading banks. In wartime, the policy was not directed to reducing the level of advances, but to preventing their expansion

for speculation and for other purposes deemed inconsistent with the war effort, such as purchases of property, repayment of mortgages, finance of hire purchase or other credit sales, and luxury purchases.

126. This policy was continued after the war. In May 1947 and again in January 1948 the Reserve Bank made public statements outlining the general scope and requirements of the Government's policy. These made it clear that advances for purely investment purposes, for capital expenditure for business, industrial, and commercial purposes including the purchase of farm properties, and (except for short periods pending the raising of finance from non-banking sources) for building, purchasing, or refinancing of dwellings were brought within the restricted classes.

127. From the outset, all marginal or doubtful cases or cases involving special circumstances have been referred to the Reserve Bank for decision, provided always that the trading bank concerned was prepared to make the advance in question. In order to safeguard the confidential relationship between customers and their own bankers, the Reserve Bank has never asked that the name of any applicant be divulged.

128. It is impossible to assess how great a part the selective advance control policy played in holding down the level of advances during the period. An obvious imperfection of the policy is that the banker cannot be sure that an advance is used for the purpose for which it has been granted. But the policy probably exerted some restrictive influence in the period up till 1949.

(iv) *The Availability of Credit-worthy Borrowers*

129. The main reason for the relatively moderate expansion of bank advances during the period 1938 to 1949 was undoubtedly lack of demand for them. Several factors were responsible for this. First of all there was a shortage of imports during the war and early post-war years and the Government paid for a much larger share of the imports than before the war; secondly, during the same period, the Reserve Bank financed the marketing of many primary products; thirdly, as men were drafted into the forces, the level of business activity in New Zealand declined to some extent and many firms engaged on war contracts received advance payments from the Government; fourthly, many activities were subject to direct controls (e.g., the demand for advances for private building purposes was low because building controls prevented an undue diversion of scarce resources into this field); and, fifthly, the overall stabilisation policy prevented any marked rise in prices, wages, and other costs, which, if it had occurred, would have necessitated higher advances.

130. Advances rose between 1946 to 1948 as imports increased, the banks regained the finance of wool exports, business returned to a peace-time basis, and controls were to some extent relaxed. But, even in 1948, fairly comprehensive import controls, controls over domestic prices and incomes, and building controls continued in operation; and the financing of meat, dairy produce, and several other primary products remained with the Reserve Bank, thus lessening the demand for trading-bank credit. In 1948–49, a small decline occurred in trading-

bank advances, probably due to the general disinflationary effect of the exchange appreciation of 1948 and, in particular, to the consequential temporary lowering in the domestic value of imported goods.

131. In brief, the position of the trading banks in 1949 was that they were holding large reserves of cash and foreign exchange in relation to their deposit liabilities; their advances were not subject to control through the reserve ratio system, and they had been unable to expand advances greatly, partly because of the selective advances control policy, but primarily because of lack of demand for bank credit in the prevailing circumstances.

The Period from 1949 to 1955

132. The following tables show the changes which have taken place since 1949 in the banks' advances (and discounts), in the overdraft limits which they have granted, but which have remained unexercised, and in the relationship between some selected bank assets and customers' deposits.

TABLE A—Trading-bank Advances and Unexercised Overdraft Limits, 1949 to 1955: Monthly Average for Calendar Year

(£ million)

Calendar Year	Advances and Discounts	Unexercised Overdraft Limits	Total
1949	82·0	57·7	139·7
1950	94·1	64·2	158·3
1951	133·1	72·2	205·3
1952	166·6	69·9	236·5
1953	134·5	93·5	228·0
1954	154·8	110·3	265·1
1955	180·0	100·8	280·8

TABLE B—Proportions of Selected Assets of the Trading Banks to Their Customers' Deposits, 1949 to 1955

Calendar Year	Bankers' Cash to Total Deposits	Bankers' Cash and Net Overseas Assets to Total Deposits	Securities to Total Deposits	Advances and Discounts to Total Deposits
	Per Cent	Per Cent	Per Cent	Per Cent
1949	45·4	53·1	7·7	43·2
1950	41·8	50·2	6·5	45·4
1951	32·5	43·2	5·2	52·0
1952	24·9	31·6	5·1	65·2
1953	39·2	46·8	5·2	50·1
1954	31·8	38·7	8·7	53·6
1955	23·7	30·2	8·7	62·3

133. There have been three main movements in the level of bank advances during this period. First, a sharp rise from 1949 till the middle of 1952; second, a sharp fall until early 1953, followed by several months of relative stability; and third, in 1954, a gradually accelerating rise, reaching a peak in March 1955, followed by a further period of relative stability with a tendency for advances to decline for the remainder of 1955.

1949 to 1952: The Demand for Advances

134. The demand for bank credit increased greatly between 1949 and 1952, due to a combination of circumstances. As indicated earlier, many controls over domestic spending and incomes and over imports were removed or substantially relaxed during these years. At the same time, both export and import prices rose and this increased the demand for advances both directly and indirectly. For instance, the spectacular increases in the price of wool in 1950 and early 1951 forced wool buyers and woollen mills to apply to the banks for more accommodation. Meat-freezing companies were similarly affected by a consequential rise in fat stock prices. The situation in respect of exports was further complicated by the prolonged waterfront dispute in the first half of 1951, which forced export industries to hold produce in store for a considerable period. Manufacturers and traders sought more accommodation to meet higher costs of imported materials or finished goods and to pay the higher wages necessitated by intensified competition for labour and by general increases granted by the Court of Arbitration in May 1950 and February 1951.

135. Moreover, there was a general tendency for all producers and traders to expand their businesses and increase their stocks to take advantage of the buoyant demand generated by these developments. Gross private capital expenditure (including changes in stocks) rose by £61 million between the year ending March 1950 and the year ending March 1952, and it is probable that bank overdrafts, directly or indirectly, played an important part in financing this expansion. As the 1952 Economic Survey pointed out, "*overdraft rates were lower than those which would have to be paid on long-term capital (after taking into account cost of issue) and interest on overdraft is a deductible expense for taxation purposes, whereas dividends are not*". Moreover, the volume of imports for the year ending June 1952 was 48 per cent higher than in the year ending June 1950. Imports became available in the second half of 1951 and early in 1952 in unexpectedly large amounts, due to increased production overseas and to the closing of alternative markets by credit restraints and import controls. Traders who had become accustomed during the post-war period of shortages to expect prolonged delays in delivery and to order more than they really required for immediate delivery were suddenly confronted with goods which they had ordered but not expected to arrive nearly so promptly. Many could not pay for these goods without assistance from their banks. For all the above reasons, the demand for bank credit was substantially increased.

Reserves of the Trading Banks

136. As we have seen, the trading banks in 1949 were in a strong position to meet this demand. Despite the large increase in their advances, balance of payments surpluses resulted in the cash reserves of the banks as a whole being maintained at a high level in relation to the increasing deposits of their customers throughout 1950, and for most of 1951. (See Table B in paragraph 132.) In this connection, it should be noted that the wool retention scheme, though it temporarily withheld a large amount of money from the wool growers, did nothing to freeze the additional reserves of overseas exchange and bankers' cash which the banks acquired as a result of the deposit of the extra money with them.

137. However, the continued expansion of the banks' advances, combined with a substantial loss of bankers' cash and foreign exchange reserves mainly due to a large balance of payments deficit in 1951–52, led eventually to a marked fall in the ratios of bankers' cash and net overseas assets to their deposits. The lowest point was reached at the end of March 1952, when the ratio of bankers' cash to deposits for the banks as a whole was 18·1 per cent, and the ratio of bankers' cash plus net overseas assets to deposits 26·4 per cent. At that time, even though the statutory minimum reserve ratio had still not been altered from the level set in 1934, one bank was forced to borrow from the Reserve Bank to maintain its statutory balance there, while others were forced to obtain temporary assistance from a primary producers' organisation for the same purpose.

Controls Over Advances

138. Although the Reserve Bank did not raise the statutory reserve ratios during this period, it made some attempt to restrain the expansion of advances by moral suasion. In the first half of 1950 the selective advance control policy was relaxed to some extent, all advances up to £2,000 being freed from control and the banks being given a greater degree of discretion in doubtful cases. However, in October 1950, steps were taken to tighten up the policy. These included requests to the banks to require shorter periods of repayment of advances, stricter attention to existing reduction programmes, tightening up on new limits, and critical examination of old ones. At this stage also the banks were asked to have regard to the quantitative aspects of advances. They were asked to tighten up generally by adopting a more cautious attitude to all requests for advances and not to pursue actively new advance business. From time to time in this period the need for caution was emphasised.

139. In November 1951, a directive was issued bringing advances for trading purposes (e.g., for stocks) within the scope of the advance control policy for the first time; and requesting the banks not to increase importers' overdraft limits without approval; although temporary "tiding-over" finance could be granted for periods up to three months in view of the abnormal circumstances which had arisen in respect of imports. In addition, the banks were asked to examine all

overdraft accounts where limits exceeded £10,000 and where customers were leaning too heavily on bank accommodation in relation to the capital structure of their businesses.

140. That the foregoing measures proved quite ineffective in the circumstances in preventing a continued expansion, both of advances and of the total volume of bank credit granted, is shown by the following table:

Movements in Bank Advances and Unexercised Overdraft Authorities, 1950 to 1952

(£ million)

Last Wednesday in Month	Advances and Discounts	Unexercised Overdraft Authorities	Total Credit Granted
1950—October	97·1	67·7	164·8
1951—January	112·6	72·3	184·9
April	135·9	73·7	209·6
July	121·4	78·4	199·9
October	143·2	67·3	210·6
1952—January	159·3	67·3	226·6
April	186·6	63·8	250·4

141. Examination of the table in Appendix H, showing the classification of trading-bank advances, indicates that the bulk of the increase in advances between March 1951 and March 1952 resulted from higher advances to merchants and wholesalers (whose advances nearly doubled), to retailers, and to industries other than primary production and processing. Many of the extra advances made in the later part of 1951 and the early part of 1952 were to importers, who had not previously arranged overdraft limits adequate to meet the cost of imports which had arrived for them. In the interests of New Zealand's credit standing overseas, the Reserve Bank permitted tiding-over finance to be granted in most of these cases to enable payment to be made. Indeed, according to the Governor of the Reserve Bank, the banks were officially requested to grant such finance, although, he said, they did not relish the prospect of carrying such high advances. However, it is clear that, quite apart from this temporary embarrassment, a substantial expansion of credit occurred despite the continued requests for restraint from the Reserve Bank in the period which we have considered. By the end of 1952, the trading-banks' liquid assets had fallen to a relatively low level and some of them were borrowing to maintain their required balances at the Reserve Bank.

1952 to 1954: The Demand for Advances

142. The following table shows a sharp fall of about £52 million in advances between April 1952 and April 1953 followed by a period of relative stability until the end of 1953:

Movements in Bank Advances and Unexercised Overdraft Authorities, 1952 to 1954

(£ million)

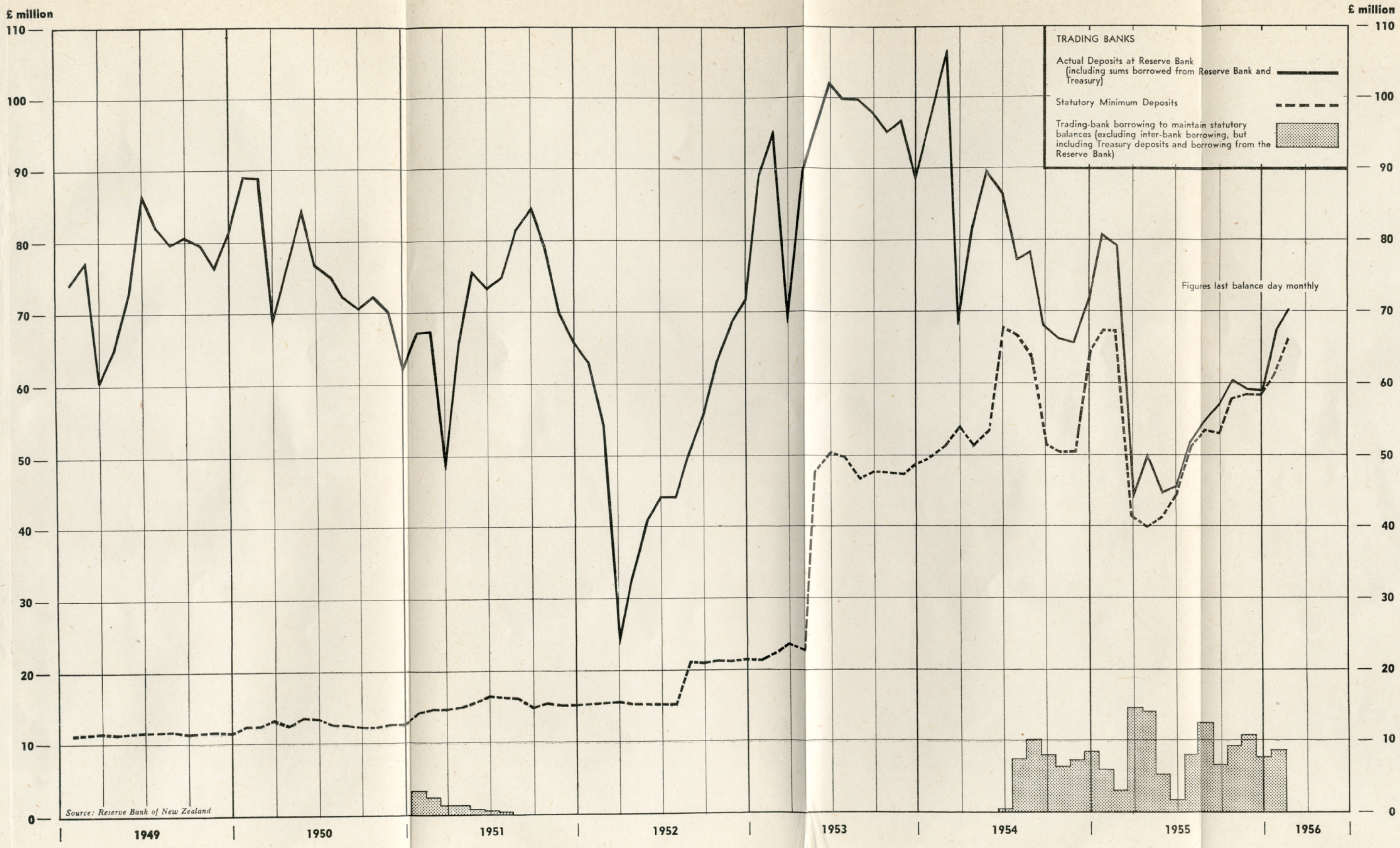
Last Wednesday in Month	Advances and Discounts	Unexercised Overdraft Authorities	Total Credit Granted
1952—April	186·6	63·8	250·4
July	171·2	67·7	238·9
October	159·4	71·7	231·1
1953—January	135·3	87·3	222·6
April	134·9	89·7	224·6
July	129·5	94·1	223·6
October	138·8	98·9	237·7
1954—January	135·8	107·0	242·9

143. The total amount of credit granted also fell between April 1952 and April 1953, but only by about £26 million, and after the middle of 1953 total overdraft limits began to rise again. The fall in bank advances between April 1952 and April 1953 was due partly to a more restrictive lending policy by the banks, but mainly to a fall from the high level prevailing in 1951–52 in the demand for bank credit. Many traders had overstocked in the import boom of 1951–52, and their demand for finance for imports fell away markedly in 1952–53. The exchange allocation scheme introduced in April 1952 and a falling tendency in import prices also reduced payments for imports to some extent. As excess stocks were run down, many advances were repaid.

Reserves of the Trading Banks and Control of Advances

144. A change in Reserve Bank policy was initiated during this period. In August 1952, the statutory minimum reserve ratios were raised for the first time to 10 per cent in respect of demand deposits and 5 per cent in respect of time deposits. Notice of this change had been given to the banks in December 1951. In December 1952, by informal agreement with the banks, the ratios were raised again to 15 per cent and 7½ per cent respectively. In May 1953, there was a further increase to 20 per cent and 10 per cent. However, as the graph facing page 276 shows, the actual balances held by the banks more than kept pace with the increases in the amounts which they were required to keep at the Reserve Bank. (This graph is based on Table 34 of Appendix H.)

145. The banks' reserves were increased primarily by surpluses in the balance of payments and by an increase in Government borrowing from the Reserve Bank in 1952–53. Certainly, the increases in the ratios left them with less free bankers' cash than they would otherwise have held, but the margin which they retained was considerable. On the average during 1953, the banks held bankers' cash equal to 39 per cent of their deposits. Thus it is unlikely that the increases in the statutory reserve ratios played any significant part in the fall of advances in 1952 and their subsequent stability in 1953. Indeed, towards the end of 1953, the overdraft limits granted by the banks were again increasing although, up till the end of that year, this had not been reflected in any significant expansion of advances.


£ million
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TRADING BANKS
Actual Deposits at Reserve Bank (including sums borrowed from Reserve Bank and Treasury)
Statutory Minimum Deposits
Trading-bank borrowing to maintain statutory balances (excluding inter-bank borrowing, but including Treasury deposits and borrowing from the Reserve Bank)
Figures last balance day monthly
Source: Reserve Bank of New Zealand

1954 to 1955: The Demand for Advances

146. From January 1954 to April 1955 advances rose by over £51 million, while the total volume of credit (including unexercised overdraft authorities) granted by the banks rose by £46 million, as the following table shows:

Advances and Unexercised Overdraft Authorities, 1954 to 1955

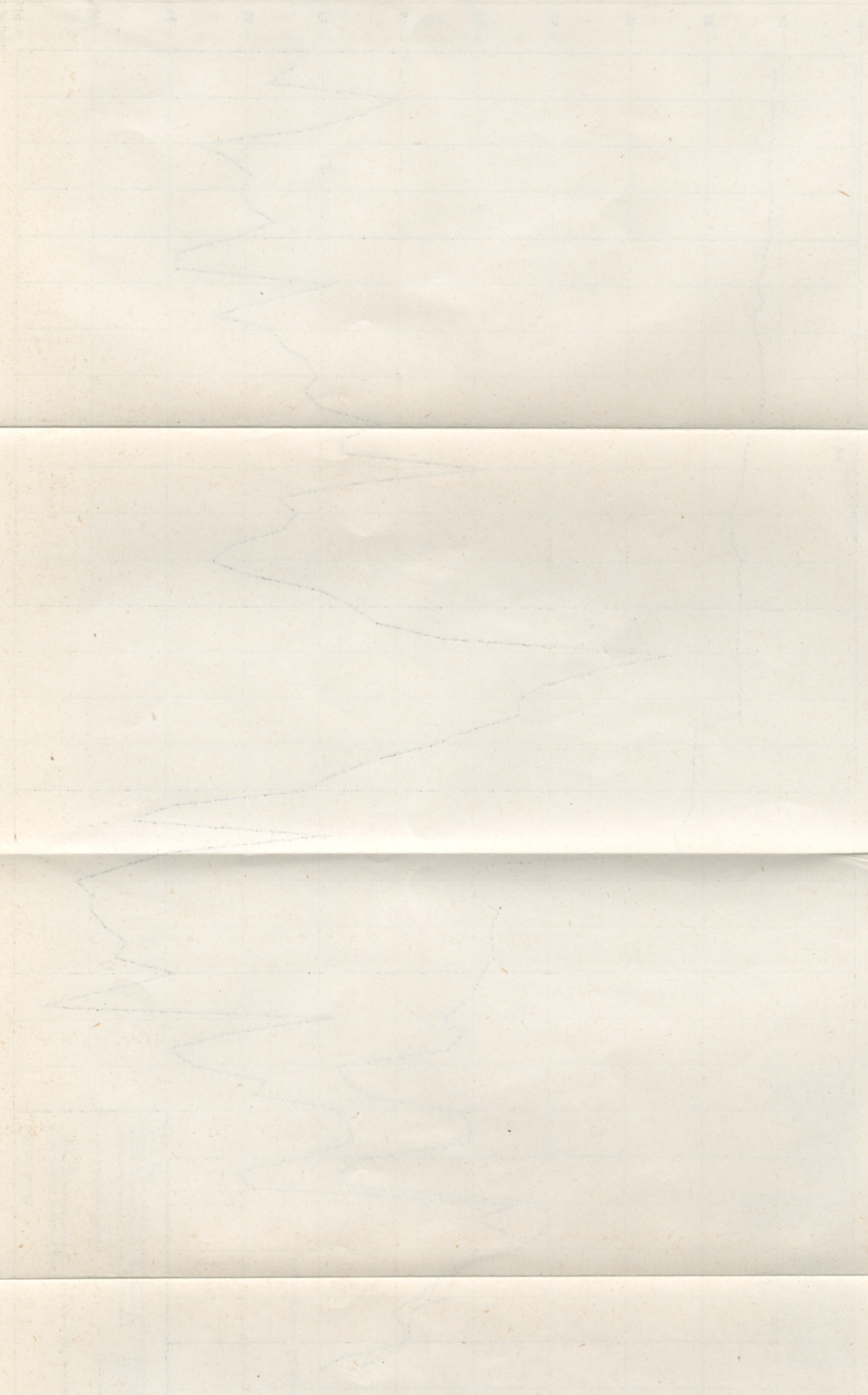
(£ million)

Last Balance Day in Month	Advances	Unexercised Overdraft Authorities	Total Credit Granted
1954—January ..	135·8	107·0	242·9
April ..	148·1	110·3	258·4
July ..	156·3	112·3	268·6
October ..	170·4	109·9	280·3
1955—January ..	167·6	112·7	280·3
April ..	186·9	102·3	289·2
July ..	184·2	100·5	284·7
October ..	178·1	95·0	273·1

147. Table 36 in Appendix H, which shows the classification of trading-bank advances, indicates that nearly £9 million of the increase in advances between March 1954 and March 1955 was to freezing works, meat companies, etc., affected by a delay in payments due to a change in marketing procedures after the termination of the bulk purchase contract. The remainder of the increase was well spread throughout the community – an extra £5 million to farmers; £3½ million to industries processing primary products; £6 million to manufacturers; £4½ million to merchants; £4½ million to retailers; £2 million to private individuals. The country was again spending heavily on capital investment and on imports, and drawing on the banks to help them to finance this spending.

Reserves of the Trading Banks and Control of Advances

148. The Governor of the Reserve Bank had mentioned to the Chairman of the Associated Banks, in February 1954, his concern at the increase in unexercised overdraft authorities, and in April 1954, when discussing the impending removal of exchange allocations, had told the banks of the necessity *"to keep a much closer contact with customers, especially importing customers"*. But, despite the large amount of bankers' cash held by the banks over and above the reserve ratio requirement in late 1953 and early 1954, no increase was made in the statutory reserve ratios until 31 May 1954, when advances were £12 million and total credit granted £17 million greater than in January 1954. Then the ratios were raised to 25 per cent in respect of demand deposits and 12½ per cent in respect of time deposits. They were maintained at this level for three months and then lowered to 20 per cent and 10 per cent between 1 September, when the Government was raising a loan of £30 million, and 1 December. The Governor of the Reserve Bank told the Commission that he had asked the banks to get in touch with customers whom they thought could subscribe to the loan. They had assured him of their co-operation, but had pointed out that if they succeeded in inducing customers to subscribe, they would lose cash to the Reserve Bank. Accordingly, the bank lowered the



ratios temporarily *"to allow that loan through"* and apparently also granted a small amount of overdraft accommodation interest free to the trading banks which had been temporarily forced to borrow even at the reduced ratios. From 1 December 1954 to 28 February 1955, the ratios were raised again to 25 per cent and 12½ per cent.

149. The Reserve Bank's interest rate for lending to the trading banks was raised from 1½ per cent to 3½ per cent in April 1954 and to 4 per cent in November 1954. However, despite these changes, the Reserve Bank was obviously making no real effort at this stage to ensure that the trading banks would be penalised if advances increased. Their policy appears to have rested on the assumption that, if the banks were left with only a narrow margin of free cash, they would feel obliged to follow a cautious lending policy in order to avoid borrowing from the Reserve Bank. Total interest payments by the trading banks to the Reserve Bank between May 1954 and 31 March 1955 were only £42,000, and virtually the whole of this was paid by the Bank of New Zealand. In the meantime, between the end of May 1954 and the end of February 1955, trading-bank advances had increased by a further £16 million and the total of advances and unexercised overdraft authorities by £21 million.

150. Between the end of February and the end of March 1955, bank advances rose by £25 million and bankers' cash fell by nearly £37 million. By the latter date the ratio of bankers' cash to deposits had fallen to 18 per cent and of bankers' cash plus net overseas assets to deposits to 27 per cent. Part of the rise in advances was due to increased requirements by meat exporters, but the major portion was a reflection of the use of bank overdrafts to pay income taxes, a practice which always raises advances in March of each year. The drain of bankers' cash was abnormally large, primarily because the Government built up a substantial balance in the Public Account as a result of an overall surplus for the year 1954–55, and partly because of a continuing deficit in the balance of payments. The drain would have been even larger if the Treasury had not placed with the four private banks short-term deposits, which rose to a peak of about £16 million early in April. The banks were charged only ½ per cent for this temporary accommodation which was finally paid off by the beginning of June; in total, they paid only £18,000 to the Treasury for it. In addition, the Reserve Bank had again lowered the reserve ratio requirements to 15 per cent of demand deposits and 7½ per cent of time deposits as from 28 February. Both of these adjustments were made because the Treasury and the Reserve Bank felt that the banks had lost cash *"for reasons unrelated to their own lending policies"* and should not be penalised on this account.

151. After March, the Reserve Bank, recognising that the level of bank advances was excessive, raised the statutory ratio in respect of demand deposits in small steps on four occasions, until the requirements reached 24 per cent in respect of demand deposits and 7½ per cent in respect of time deposits on 7 October 1955. These increases served to keep the banks as a whole "in the red" at the Reserve Bank, to an amount of about £10 million on the average between April and December. Also abnormally large amounts of sterling were sold to the Reserve Bank in order to avoid borrowing. About 55 per cent of the borrowing in these months was by the Bank of New Zealand and, in mid-December, this bank borrowed £3 million from the Treasury for a short period. However,

the Bank of New Zealand always held notes and overseas assets considerably in excess of its borrowings from the Reserve Bank. The General Manager has informed the Commission that the Bank of New Zealand's holdings of notes have been no more than adequate to service its day-to-day business, which includes a substantial number of transactions on behalf of the Government. It is estimated by the Reserve Bank that the Bank of New Zealand requires to hold an additional £3 million of notes throughout the year, and £5·5 million over the Christmas period, on account of its Government business. Because of this need to hold substantial quantities of notes, the Bank of New Zealand is granted overdraft accommodation by the Reserve Bank when required, free of interest up to £3 million or £5·5 million whichever is appropriate. The General Manager also informed the Commission that, as a matter of principle, his bank preferred to maintain a Reserve Fund of £3·575 million in British Government securities. He believed that the holding of a proportion of its reserves and assets in other than New Zealand stock added strength to its operations through diversity of investment. Taking into account the bank's business in Australia, Fiji, and Samoa, he said that its liquid assets overseas were no more than adequate to serve the day-to-day requirements of the bank.

152. The Reserve Bank's interest rate on borrowing by the trading banks was raised on three occasions in 1955 – from 4 per cent to 5 per cent in July to 6 per cent in September and to 7 per cent in October. As a result, interest payments by the banks to the Reserve Bank increased, £86,000 being paid between 1 April and 30 September and £52,000 between 1 October and 31 December.

153. Concurrently, advances fell from £189 million at the end of March 1955 to £176 million at the end of December 1955, and total credit granted fell from £288 million to £273 million in the same period. However, as at the end of December 1955, advances were still £10 million higher than in December 1954, although total credit granted had fallen by £6 million in the same period. How far this greater restraint in lending was due to the firmer policy adopted by the Reserve Bank during the period cannot be estimated. In the light of their relatively low holdings of bankers' cash, and of the continuing deficit in the balance of payments, it would appear to have been in the interests of the banks themselves to follow a conservative lending policy, irrespective of the level of the reserve ratios or of the interest rate charged by the Reserve Bank. Mr Whyte confirmed in evidence that the banks would have been following similar policies to those now being pursued, whether or not reserve ratio controls had been in force.

(d) OVERSEAS TRANSACTIONS

154. As we have seen, the volume of money is increased in New Zealand when there is a surplus in the balance of payments and reduced when there is a deficit. Overall, New Zealand has had a substantial surplus in its overseas transactions since 1935, and this has added a large amount to the volume of money. The trends in the balance of payments during the period are indicated in the following table which shows the effect of overseas transactions on the volume of money in the years concerned.

Effects of Overseas Transactions on the Volume of Money, 1935 to 1955

June years—	£ million	June Years—	£ million
1935 to 1939.. ..	−36·5	1951 to 1952	−48·7
1939 to 1947.. ..	+99·3	1952 to 1954	+64·6
1947 to 1949.. ..	− 9·4	1954 to 1955	−35·5
1949 to 1951.. ..	+43·3		

155. The causes of these changes in the balance of payments position are discussed elsewhere in this report. At this stage, it is only necessary to note that a surplus in the balance of payments not only has the direct effect on the volume of money indicated in the table above, but also, by adding to the basic reserves of the trading banks, makes possible an expansion of trading-bank credit. A deficit has the opposite effect. The expansion of bank advances which has occurred during the period which we have surveyed would not have been possible in the absence of the large additions which have been made to the banks' reserves through surpluses in the balance of payments.

156. Overseas transactions also have other indirect effects on the volume of money in New Zealand. Even if overseas receipts and overseas payments remain in balance, a rise in export and import prices is likely, in the absence of State intervention, to lead to an increase in the volume of money. For those handling exportable or imported goods, or goods made with exportable or imported raw materials, are likely to require more overdraft accommodation to cover increased costs. And if, as often happens, wages are increased as a result of the increases in incomes of primary producers and in the consumers' price index generated by price increases overseas, there will be a further demand for advances to pay the extra wages. If the banks meet this higher demand, the volume of money will be correspondingly increased. Since 1935 export and import prices have increased by 300 per cent and 186 per cent respectively. In view of the large part which exports and imports play in the economy there is no doubt that the increases in these prices have been an important cause of the expansion of bank advances and of increases in the volume of money since 1935. (A fall in export and import prices would, of course, have the opposite effect in the absence of State intervention.) Not only the prices, but also the quantities of exports and imports have increased since 1935. The total value of external trade rose from £83 million in 1935 to £479 million in 1954. Consequently, a large increase in bank advances to persons directly or indirectly involved in external trade was inevitable and essential.

157. During the last twenty years the Government has taken several measures, outlined in more detail above, to protect the economy from some of the effects which arise from increasing overseas prices. It is interesting to consider the effect of these measures on the volume of money. The stabilisation schemes for dairy produce and meat withheld from the farmers some of the proceeds from the sale of their produce overseas; but these proceeds were not "frozen" at the Reserve Bank in the name of the marketing organisations concerned. They were invested in Government securities and spent by the Government on capital works, thus becoming deposits or notes in the hands of those paid by the Government. At the same time, the expansion of deposits increased the basic reserves of the trading banks, thus increasing their ability to lend. However, the stabilisation schemes for these products were an important part of an overall system of stabilisation made possible by the co-operation of important sections of the community, which fairly effectively

held down costs and prices for several years and thus helped to limit the demand for bank advances during that period. Therefore, while the stabilisation schemes did not directly reduce the volume of money in circulation, or the banks' ability to lend, indirectly they played an important part in curtailing the demand for credit and thus holding the volume of money below the level which it would otherwise have reached.

158. The exchange appreciation of 1948 was another measure which offset some of the effects of rising overseas prices. One result of making £100 sterling worth only £100(N.Z.) instead of £125(N.Z.) as before, was to reduce the value in New Zealand money of produce exported to 20 per cent below the level which would otherwise have ruled. In the case of wool this meant that less deposits were made available to growers and less cash made available to the trading banks than they would otherwise have received. In fact, wool receipts rose almost enough to give growers the same return and the banks the same accretion of cash as before. In the case of dairy produce and meat, the returns to producers were in any case, under the stabilisation scheme, unrelated to external receipts, so that the appreciation had no immediate effect on the payments to them. But the exchange appreciation reduced the amounts of New Zealand money which would have been added to the stabilisation accounts, and thus reduced the amounts available for investment in Government securities. As we have seen, as a result of this and other circumstances, the Government increased its borrowing from the Reserve Bank. Thus, while the immediate effect of the appreciation was to reduce the volume of New Zealand money made available through export receipts, the effect of this reduction was offset to some extent by subsequent Government borrowing from the Reserve Bank.

159. The New Zealand price of imports was also reduced by the appreciation of the New Zealand pound, and this meant that less New Zealand money and, therefore, less drain on the banks' reserves of cash and foreign exchange, was involved in buying imports of a given sterling value. From this side then, since the volume of imports remained relatively stable in the following year, the volume of money, and the banks' ability to lend, were reduced less than would otherwise have been the case.

160. The net effect of the appreciation was probably in the direction of reducing the volume of money. Indirectly it reduced the demand for bank advances by reducing the domestic price of goods with a high export or import content, and by removing some of the factors which might otherwise have provided justification for a general increase in wages. Since costs were held below the level which they would otherwise have reached, producers and traders needed less advances to finance their operations.

161. The wool retention scheme "froze" temporarily in trading-bank accounts about £32 million of the proceeds from the sale of wool in the "boom" year 1950–51. The volume of money was thus temporarily reduced below the figure which it would otherwise have reached. But nothing was done to "freeze" the additional reserves which the banks acquired as a result of the deposit of this money with them and their ability to lend was thereby increased. If these amounts had been "frozen" at the Reserve Bank, it is probable that the trading banks would have been unable to expand advances to as great an extent as they did in 1951–52.

162. The foregoing paragraphs illustrate the importance of overseas transactions in governing the supply of money and the general level of economic activity in New Zealand and indicate some of the difficulties involved in attempting to insulate the economy from the effects of fluctuations in prices overseas. We discuss these difficulties in more detail elsewhere. The almost continuous rise in export and import prices, and the overall surpluses which have occurred in the balance of payments, have been basic causes of the increase in the volume of money which has occurred since 1935. The direct and indirect effects of the price rises made a large increase in bank advances essential; the surpluses in the balance of payments provided the banks with a large proportion of the basic reserves necessary to meet the increased demand for accommodation. Whether the increases in bank advances and in the supply of money which have taken place should be regarded as excessive is examined elsewhere.

Section Three: New Zealand's Credit System

I. THE IMPORTANCE OF THE CREDIT OR DEBT SYSTEM

163. A notable characteristic of any reasonably advanced economy, based primarily on the institutions of private ownership and enterprise, is the existence of a large volume of debt. At the same time (although this is not universally appreciated) there exists a large volume of credit, since a loan of money within the country simultaneously creates an asset for the creditor and a liability for the debtor. In general, debt is the consequence of the use of one person's savings by others.

164. Many witnesses who appeared before us, especially those who had some connection with the Social Credit movement, expressed great concern at the growth of public and private indebtedness in New Zealand in recent years, and some witnesses claimed that it was unnecessary for debt to exist in the economy at all. It seems desirable, therefore, to examine the importance of debt and credit, and the structure of the debt or credit system in New Zealand.

Is Debt Necessary?

165. The efficiency of any economy, and, therefore, the standard of living which the people of that economy can enjoy, depends very largely on the ability and willingness of the people to build up and maintain an adequate stock of productive capital. Modern techniques of production and sale require large and expensive factories and warehouses, shops and offices, machinery and tools. There must be efficient means of transport by road, rail, sea, and air, and adequate supplies of power. In the case of farming, buildings and machines and adequate fencing, drainage, etc., are required; the soil or pasture must be maintained or improved by the application of fertiliser; and livestock must be reared for breeding or production. Producers generally must hold stocks of raw materials, semi-finished, and finished goods to maintain continuity of production; to overcome disruptions of supply due to transport stoppages,

etc., or to meet as quickly as possible the fluctuating demands of producers and consumers. Moreover, the efficiency of producers depends heavily on housing and household facilities, and on the premises and equipment used for educational and health services.

166. Thus, in a modern economy, only a relatively small proportion of the population is engaged in producing goods which will immediately be sold to consumers. Nevertheless, it is the fact that in the past so much of our effort has been devoted to building up and maintaining our stock of capital, which has largely made possible the standard of consumption which we now enjoy. Our stock of capital per head must be maintained if we wish to preserve our standard of living and it must be increased if we want to improve that standard.

167. To maintain or increase the capital assets required for an efficient economy necessitates using the services of workers who, and resources which, might otherwise be directly producing consumer goods and services. These workers and resources and their products must be paid for, and to enable them to be paid for either new money must be created for the purpose or some persons must forego the right to use existing moneys to buy consumer goods. This being so, and on the assumption that we wish to retain the means of production predominantly in private hands, it seems clear to us for reasons given below that indebtedness of one section of the community to another is inescapable.

168. Few private individuals or small groups of individuals could provide from their own incomes or from their accumulated savings sufficient money to finance the building, equipment, and stocking of a modern factory or shop, or the purchase and development of a farm. If people wish to obtain control of productive capital of this kind, they must induce other persons, either directly or through some financial institution, to lend part of the money necessary to pay for such capital.

169. Similar considerations apply in the case of persons who wish to own their own home or to obtain relatively expensive home utilities. In the long run, many could no doubt save sufficient to pay for these things out of their own resources – but, since life is short, it is often judged more desirable to borrow the money necessary and repay it over a period of time.

170. Local authorities also require money to pay for installation of water and sewerage facilities, roads and footpaths, reserves, and so on. Many of the authorities could avoid borrowing by sharply increasing their rates to cover all capital expenditure. But this would impose an intolerable financial burden on ratepayers in relation to annual income. It is usually much more equitable and convenient to borrow from those (either within or outside the locality) who have money to spare, so that ratepayers may pay for their amenities over a number of years.

171. The Central Government could, if it wished, raise all the money necessary for its capital works programme from taxation, and, especially at times when resources are fully employed, there is merit in its doing so. But it is often more convenient – and may have a less adverse effect on the incentive to produce – to raise part of its requirements through voluntary loans rather than through compulsory taxation. Again, as several witnesses stressed, the Government has the power to avoid completely the necessity of borrowing (or taxing) for its public works by

requiring its central bank to issue money to it. But as we point out in Part IX of Appendix E, it would generally be most unwise to do so; for, if workers and resources were fully employed, as they have been in New Zealand in recent years, continual injections of new money of this magnitude would merely drive up costs and prices, as the members of the community competed with one another to spend the increasing supply of money on a relatively constant supply of goods and services. Thus the Government's requirements would be met, not at the expense of those most able to pay, but at the expense of those least able to increase their incomes to keep pace with rising prices. In circumstances of full employment some must save in order to enable public works to proceed. The Government must choose between borrowing the voluntary savings of the thrifty members of the community on the one hand and forcing people to restrain their consumption either through taxation or through rising prices caused by inflation on the other.

172. If expansion of the money supply through Government borrowing from the banking system were resorted to continuously and prices persistently rose, the public would ultimately lose confidence in the value of money and the entire monetary and economic system would be violently disrupted. Similar considerations are relevant to proposals made to us by some witnesses that all capital expenditure, public and private, should be financed by the issue of new "debt-free" credits rather than by borrowing money already in existence. One needs only to note that the total of private and public capital expenditure in New Zealand was £211 million in 1954–55 to appreciate the extravagance of such proposals.

Why Should Interest be Paid?

173. Many witnesses claimed that the fact that interest had to be paid on borrowed money imposed an intolerable burden on the community and that steps should be taken at least to reduce and probably to abolish interest. The subject of interest is a complex one and cannot be discussed adequately in a short space. We discuss it more fully in the main sections of our report. Suffice it to say here that the payment of interest serves three main useful purposes:

(a) It encourages saving.
(b) It induces those with money available to lend it.
(c) It acts as a restraint on excessive demands for loan money and thus makes it easier to apportion the available supply.

174. If no interest were paid, there would be little inducement to lend money. Losing control of money by lending it inevitably involves risk that the borrower will be unable or unwilling to repay, the degree of risk depending on the nature of the borrower. Some reward is therefore necessary to induce people to lend rather than to hoard. A reward is also necessary to induce people not to spend their money. For instance, if no interest could be earned on money lent, more people would buy property and let it, or buy other assets, from which they could earn an income or derive satisfaction, and which they could sell again for money in the future. This applies particularly when people expect prices of property and other assets to rise. Moreover, the collection and lending of money by the financial institutions, which are the most important sources of loan money in New Zealand, is by no means a costless process and some reward must be paid to cover the costs

involved. Those persons who must be employed to collect deposits and premiums, interview applicants for loans, examine their credit worthiness, and so on, must receive their salaries or wages and the buildings and equipment they use must be paid for and maintained. If no interest could be earned on loans, financial institutions – if they managed to survive – could pay no interest on deposits, and would have to charge much more for the services they provide to depositors or policy holders. It is not generally recognised that the abolition of interest would adversely affect not only a few wealthy people or financial institutions, but also all owners of deposits at trading and savings banks, those holding insurance policies or subscribing to superannuation schemes, members of building societies, and so on. (We discuss these points again in Part VIII of Appendix E.)

175. The other main function of interest is to provide some restraint on demands for loan money, and to serve as a device for the apportionment of the available supply. As we have seen, obtaining control of large sums of money is useful to many persons, for it enables them to adopt more efficient or less costly methods of production and thus, in many cases, to increase their profits. That is why they are willing to pay interest for a loan. The lower the rates of interest are, the more capital projects become profitable, provided the existing level of costs and prices is maintained. In addition, the lower the rates of interest are, the less sacrifice is involved for consumers or public authorities in borrowing to increase their assets. Thus, with lower rates of interest, the demand for loan money is likely to be greater. Rates of interest tend to rise when loan money becomes scarcer in relation to the demand for it and to fall when it becomes more plentiful. Many people regard it as unfair that the price of loan money should rise when it becomes scarce; but before this view is accepted it is necessary to examine the alternatives to allowing the price to rise.

176. If rates of interest threaten to rise to levels higher than the Government thinks desirable, because the demand for loan money is outstripping the supply, the Government can hold them down in two main ways:

(a) The Government can issue more money through the banking system to meet the demand for loans. This might be desirable if resources were not fully employed. However, as we have seen, our resources are too limited to allow everyone to have everything he wants, and when resources are fully employed, the main effect of the issue of new money would be rising prices. In these circumstances, an attempt to maintain a "fair" rate of interest by such means could result in forcing up the prices of goods and services to a level "unfair" to a large section of the community.

(b) The Government can fix interest rates for various types of loans and prohibit the charging of rates greater than the fixed rates. But there are difficulties involved in such control, and the greater the difference between the controlled rates and the rates which would rule in an uncontrolled market, the greater these difficulties would be. For instance, if the demand for loan money is greatly in excess of the supply, some attempt must be made by the State to apportion what is available and especially to ensure that "essential projects" receive an adequate share. This involves the necessity for decisions by a State authority on a rather arbitrary basis as to which firms or local authorities shall be permitted to raise money and which shall not. Without a cumbersome bureaucratic machine, a measure of borrowing and lending activities must be left outside the scope of the controls, with the consequential possibility of evasion by certain types of enterprise. Where some interest rates are left free while others are pegged, it may be difficult for those subject to rate fixation to attract funds.

177. An attempt to abolish interest altogether would create an almost insatiable demand for credit, while substantially reducing the supply of money available for borrowing; in these circumstances it is hard to see any alternative to complete control by the State of the allocation of loan moneys. Taxation would be necessary to provide an adequate supply and some authority would have to decide which of the many applicants for loans would be granted loans.

178. Thus, attempts to abolish interest would, in the view of the Commission, prove disastrous and attempts to hold interest rates excessively low are fraught with difficulty. The crux of the matter is that loan money, like goods and services, is scarce in relation to the amounts which people would like to have. It is necessary, therefore, to apportion the available supply in some way. This can be done either by charging a price for it, thus discouraging some of the potential demand, or by allocation by some authority. There are occasions, as in the case of goods and services, when direct controls over interest rates and demands for credit are desirable to prevent spectacular rises which might occur due to a temporary scarcity of loan money. Control of interest rates may also be necessary as part of an overall stabilisation policy in times of emergency. But, as a general rule, the Commission believes that it is desirable to allow the apportioning to be done through the price mechanism.

179. It may be objected that, since large firms and wealthy people can afford to pay a higher price than small firms and poorer people, such a policy is inequitable. But we believe that, if it is considered at any time that the distribution of income is inequitable, it is better to correct it by taxing those with high incomes and giving to those with less, rather than to interfere arbitrarily with competitive loan or other market transactions, especially when such interference can, at best, have only limited success in achieving its objective.

Conclusion

180. To sum up: Our credit or debt system performs the following useful functions:

(a) It provides, without excessive inflation of the money supply, a means of calling forth the funds required for modern production and of apportioning the available supply of loan money without undue intervention by the State.

(b) It enables those who wish to save money for various reasons to earn an income from their savings without investing them directly in property or business.

(c) The specialist financial intermediaries in the credit market aggregate small savings into amounts large enough to be of use in production; they develop experience in assessing the credit worthiness of applicants for loans; and they reduce the cost of marketing credit below that which would rule if people had to find outlets for their own funds.

(d) The system enables private firms and individuals to obtain control of the expensive fixed and working capital necessary for efficient production; it enables families to obtain houses, home utilities, and ancillary services (through their local governments) earlier in life than if they had to provide them completely from their own resources.

181. A society without debt and interest would be inconsistent with the institutions of private ownership and enterprise, for the funds for capital expenditure would inevitably have to be collected and allocated by the State.

II. THE MAJOR BORROWERS IN THE NEW ZEALAND CREDIT SYSTEM

The Central Government

182. Government borrowing has always been important in the credit market in New Zealand and the Government has considerably increased its nominal indebtedness during the period under review in this report. Table A on page 287 indicates the changes which have taken place in the New Zealand public debt, both internal and overseas, and of the sources of the funds which have been raised.

183. It will be seen that the public debt increased from £313 million to £731 million between March 1934 and March 1955. However, these figures obscure an important change in the domicile of the debt. The overseas debt of the Government fell during the period from £174 million to £100 million due primarily to the repayment of nearly £50 million during the year ended 31 March 1946, while its internal debt rose from £139 million to £631 million. Overseas debt, therefore, comprised only about 14 per cent of the total in 1955 as compared with 56 per cent in 1934. As a result of this, and of some reduction in interest rates, the annual interest payments which the Government made overseas fell from £6·1 million in 1933–34 to £2·8 million in 1954–55. As a percentage of the country's export income, the overseas interest payments fell from 13·3 per cent to 1·1 per cent in the same period.

184. Moreover, the rise in the total nominal debt and the interest paid on it must be considered in relation to the increase in the national income which has occurred since 1934. The gross national income in 1933–34 is estimated to have been £127 million; in 1954–55 it was £927 million. Thus the Government's debt was equivalent to only 79 per cent of the gross national income in 1955, as compared with 246 per cent in 1934.

185. Table B on page 287 shows the amounts of interest paid on the public debt in the years concerned and their relationship to the gross national income and to the total taxation collected by the Government.

TABLE A—Investments in Government Securities (Stock and Treasury Bills) as at 31 March
(£ million)

—	1934	1939	1946	1950	1955
1. Post Office Savings Bank(1) ..	41·5	51·3	143·3	136·7	118·1
1A. Post Office Savings Bank (including S.A.C. securities) ..	41·5	57·0	145·2	168·9	214·9
2. National savings	..	..	35·0	45·7	63·5
3. Trustee savings banks ..	2·7	3·8	20·7	29·9	28·1
4. Insurance companies(2) ..	15·0	15·6	38·8	51·7	56·6
5. Government superannuation ..	0·7	1·5	2·2	5·7	15·8
6. National Provident(2) ..	1·9	3·7	6·9	8·9	5·4
7. Earthquake and war damage ..	..	..	4·7	6·7	12·1
8. Reserve Bank	..	14·5	45·6	91·0	60·4
9. Trading banks(1)	23·5	10·1	26·8	11·7	11·8
10. Meat Industry Account ..	..	..	8·0	27·5	38·6
11. Dairy Industry Account ..	..	..	6·2	14·2	14·4
12. Wool Commission	..	..	..	13·0	25·7
13. Other Government accounts (within Public Account, Maori Trustee, Marketing, Broadcasting, etc.) ..	..	..	14·5	30·2	51·4
14. State Advances Corporation ..	..	..	3·0	1·0	2·3
15. Public Trustee	2·9	4·1	7·8	4·4	4·6
	88·2	104·6	363·5	478·3	508·8
Other public holdings ..	50·8	41·6	109·2	86·8	122·0
Total holdings of government securities domiciled in New Zealand(1) ..	139·0	146·2	472·7	565·1	630·8
Overseas Debt of New Zealand Government	173·9	166·8	121·6	80·9	99·9
Total indebtedness(1) ..	312·9	313·1	594·4	646·0	730·7
Percentage of other public holdings to total holdings in New Zealand ..	36·5%	28·5%	23·1%	15·2%	19·3%
Percentage of overseas debt to total indebtedness	55·6%	53·3%	20·5%	12·5%	13·7%

(1) Excludes State Advances Corporation securities.
(2) Figures for previous December.

TABLE B—Interest Paid on General Government Debt Compared With Gross National Income and Total Taxation
(£(N.Z.)million)

—	Year Ended March				
	1934	1939	1946	1950	1955
Interest paid overseas	6·1	6·8	7·1	2·8	2·8
Interest paid in New Zealand ..	5·6	4·7	11·5	13·9	17·2
Total	11·7	11·5	18·6	16·7	20·0
Total interest paid as—					
(a) Percentage of gross national income	9·2%	5·0%	4·7%	3·0%	2·2%
(b) Percentage of total tax collected	54·5%	30·4%	16·2%	12·3%	8·5%

It can be seen that, although the amount of interest paid has risen considerably in money terms, it has declined markedly in relation to the gross national income and to total taxation.

186. Table A on page 287 gives a broad indication of the sources of the funds which the Government has borrowed. The most striking feature of the table is the large proportion of the Government's debt which is held by the Post Office Savings Bank. Its importance as a source of funds for the Government becomes even more striking if account is taken of borrowing by the State Advances Corporation, which is not included in the public debt figures, except in so far as money has been allocated to the Corporation from general Government loan funds for investment in State housing, rehabilitation loans, etc. The figures in Item 1A indicate the amounts lent by the Post Office to both the Government and the Corporation. Since the total of stock and debentures of the Corporation outstanding at 31 March 1955 was £114 million, it is obvious that the Post Office Savings Bank is by far its greatest creditor, holding in the region of £97 million worth of State Advances Corporation securities. The bulk of the remainder of the Corporation's stock is held by the trading banks.

187. During and since the war, the Government has also borrowed large additional amounts from national savings and up till 1950 from the trustee savings banks. At the end of March 1955 it was indebted to "small savers", through the savings institutions we have mentioned, to the extent of about £210 million (or about £307 million if the State Advances Corporation's debt is included).

188. The next important group of institutions from which the Government has borrowed is that which assists the people to make provision for their old age or to cover the risks of death, accident, and so on. At the end of March 1955 the Government was indebted to insurance companies, its own superannuation funds, the National Provident Fund, and the Earthquake and War Damage Fund to the extent of nearly £90 million.

189. The banking system is the source of most of the Government's short-term borrowing in anticipation of revenue. It has also been an important provider of long-term credit. Changes in Government indebtedness to the banking system have been discussed fully in paragraphs 91 to 105 above. The main point to note here is that the trading banks hold only a small proportion of the public debt domiciled in New Zealand – under 4 per cent, even if account is taken of their holdings of State Advances Corporation stock. Further, the greater proportion of this debt is held by the State-owned Bank of New Zealand.

190. Other important sources of Government finance during the war, and up till about 1953, were the various funds, set up primarily under the stabilisation agreement examined elsewhere, to accumulate reserves for the benefit of the primary industries. The necessity to seek loan money from the general public was substantially reduced during the early post-war period due to the availability of finance from these funds; this is undoubtedly a major factor in explaining the fall in "other public holdings" between 1946 and 1950. Since it was decided about 1952 virtually to cease the further accumulation of reserves in these funds,

the Government has become much more dependent on the general public for its requirements. As at 31 March 1955, the Meat Industry Account, the Dairy Industry Account, and the Wool Commission together held Government securities of a nominal value of £79 million.

191. In March 1955, £51 million of the securities domiciled within New Zealand were held by various Government Departments. This represented, in the main, the temporary investment by these Departments of cash balances received from various sources which they found it impossible or unnecessary to spend in other ways. Virtually, then, this part of the public debt is owed by one Government account to another.

192. Minor amounts have been obtained from investment of trust moneys, etc., by the Public Trustee, and from the investment of the General Reserve Fund of the State Advances Corporation.

193. Thus the bulk of the public debt in New Zealand is held by Government-owned institutions, by savings banks and insurance companies, and by reserve accounts set up for the benefit of the primary industries. Interest payments on the debt therefore benefit, directly or indirectly, a very large number of the people of the country.

194. Although the allocation to particular purposes of the sums borrowed by the State is to some extent arbitrary, an idea of the uses to which the funds have been put may be gained from the following table taken from the 1955 Financial Statement by the Minister of Finance:

Allocation of the Public Debt as at 31 March 1955 According to the Expenditure Appearing in the Departmental Accounts

		£ thousands
Bank of New Zealand (shares)		7,709
British Petroleum Co. of New Zealand Ltd.		1,275
Christmas Island phosphates		1,389
Education buildings		19,600
Forests (State)		11,770
Harbours and lighthouses		400
Housing		89,163
Hydro-electric schemes		99,695
Land settlement and improvement		33,252
Mining		7,136
Murupara development		3,779
National development loans		7,191
New Zealand National Airways Corporation		1,200
New Zealand Woolpack and Textiles Ltd.		150
Post and Telegraph services		42,675
Public buildings		3,189
Railways—	£	
Capital	103,554	
Lines under construction	6,914	
		110,468
Reserve Bank exchange adjustment		20,000
Roads and highways		55,620
Soil conservation, irrigation, and drainage		10,918
Tasman Empire Airways Ltd.		811
Tasman Pulp and Paper Co. Ltd.		8,400
War expenses (1939–45)		188,485
Miscellaneous assets and services		2,156
Cash and investments in hand		4,253
		£730,684

195. A large part of the public debt has been invested in undertakings which return considerable revenues to the State as well as assisting in the development of the nation's industry and commerce. The interest and profits received by the State in 1954–55 from public enterprises in which money received from borrowing is invested amounted to £11·4 million. The Government's interest and management charges in the same year were £21 million, so that about 55 per cent of the interest and management cost was recovered from the investments.

196. Although the money borrowed by the Government and spent on roads and bridges, on schools, and on other forms of social capital does not return monetary profits, it is productive.

Local Bodies

197. New Zealand's development and growth of its population require an increasing supply of basic local services such as water supply, sewerage, and street improvements, and the improvement and expansion of hospital services, transport facilities, and electric power. Local bodies play an important part in providing these services and must necessarily borrow from time to time to meet the heavy capital costs involved.

198. The following table indicates the changes which have taken place in the total gross indebtedness of local bodies since 1934, the relative proportions of their debt held in New Zealand and overseas, and the major sources of the money borrowed:

Investments in Local Bodies' Securities

(£ million)

—	As at 31 March				
	1934	1939	1946	1950	1955
Post Office Savings Bank	0·4	0·6	0·4	0·3	0·2
Government Superannuation Funds	0·8	1·1	0·9	0·6	0·4
National Provident(1)	0·2	0·5	0·4	1·1	9·1
Public Trustee	7·9	6·8	5·8	4·8	3·2
State Advances	4·6	6·2	5·4	5·5	6·4
Other Government Accounts	0·1	0·3	0·2	1·0	0·9
Maori Trustee	..	..	..	..	0·1
Trading banks	0·2	0·3	2·4	1·7	2·1
Trustee savings banks	1·9	2·5	2·6	2·5	5·3
Insurance companies(1)	16·3	19·9	23·3	25·7	32·6
	32·4	38·2	41·4	43·2	60·3
Other public holdings	20·0	17·2	15·2	13·2	26·3
Total holdings of local bodies' securities domiciled in New Zealand	52·4	55·4	56·6	56·4	86·6
Overseas indebtedness of local bodies	25·1	18·0	9·4	5·3	4·0
Total indebtedness of local bodies	77·6	73·4	66·0	61·7	90·5
Percentage of other public holdings to total holdings in New Zealand	38·2%	31·0%	26·9%	23·4%	30·4%
Percentage of overseas to total indebtedness	32·3%	24·5%	14·2%	8·6%	4·4%

(1) Figure for previous December.

199. It will be noted that the total indebtedness of local bodies showed a gradually declining trend from 1934 till 1950, the only interruption to the trend being a slight rise in indebtedness between 1938 and 1940. As a consequence, total indebtedness in 1950 was nearly £16 million less than in 1934. Since 1950 local body debt has increased at an accelerating rate, passing the 1934 figure in 1954 and reaching £90·5 million at 31 March 1955.

200. A notable fact shown by the above table is the decline in the overseas indebtedness of local bodies. It has apparently been a matter of Government policy to discourage borrowing overseas by local bodies. Many local bodies themselves would in any case be reluctant to take the risks involved in the possibility of a depreciation of the exchange rate, which if it occurred would increase their annual interest payments in terms of New Zealand currency. Local body debt held overseas was over £21 million less in 1955 than in 1934, and represented only 4·4 per cent of total indebtedness as compared with 32·3 per cent in 1934.

201. The following table indicates that, despite the recent rise in indebtedness, local bodies have to devote a much lower proportion of their total revenue to interest payments than they did before the war:

Interest Charges on Loans and Overdraft as a Percentage of Total Revenue

—	Total Revenue	Interest on Loans and Overdrafts	Percentage of Interest to Total Revenue
	£ million	£ million	
1934	14·2	3·5	24·6
1939	18·7	3·0	16·0
1946	24·5	2·5	10·2
1950	32·7	2·3	7·0
1953	44·1	2·3	5·2
1955	57·3	2·9	5·1

NOTE.—This table does not cover the operations of hospital boards.

202. A number of factors are responsible for the fall in local body indebtedness between 1934 and 1950. Among them are:

(a) Shortages of labour and materials preventing any major expansion of works projects.

(b) The policy adopted, under the guidance of the Local Government Loans Board, of making provision for repayment of loans within a reasonable period related to the life of the assets provided from the loans.

(c) A tendency for many local bodies to meet a substantial part of the cost of works from current revenue.

(d) The transfer to general Government taxation of certain local body costs, especially the cost of hospital works.

203. Since 1950 the rapid population increase, the expansion of housing construction (especially on the outskirts of the main cities), and a somewhat increased supply of more costly labour and materials has led to a sharp increase in local body expenditure on the extension of the facilities which they provide, necessitating greater recourse to loan finance.

204. Some indication of the magnitude of the increase in the demand for loan money by local bodies in the past few years is given in the following table, showing applications to the Local Government Loans Board for approval to raise loans:

Year Ended 31 March	Total New Applications
	£
1946	3,497,820
1947	9,843,543
1948	8,324,579
1949	8,934,705
1950	8,062,758
1951	10,825,192
1952	15,092,761
1953	29,129,996
1954	24,908,485
1955	28,586,666

205. An indication of the purposes for which loans have been sought and sanctioned is given below:

Details of New Loans Sanctioned by the Local Government Loans Board from 1 April 1951 to 31 March 1955

March Year	1951–52	1952–53	1953–54	1954–55
	£	£	£	£
Waterworks	820,650	1,633,820	1,352,830	4,050,820
Drainage and sewerage	109,300	1,298,875	4,471,935	6,409,405
Roads, streets, and bridges	1,146,980	2,638,885	1,378,000	2,577,340
Public buildings	93,550	642,425	624,000	572,750
Public transport	2,476,000	7,000	850,200	2,723,200
Recreational facilities	270,050	276,890	58,800	408,950
Housing	601,757	496,920	561,200	1,526,800
Electricity supply	2,502,050	2,498,600	2,471,500	2,962,150
Hospital works	1,991,500	2,192,550	4,047,200	2,204,500
Harbour works	2,876,100	5,061,500	1,448,000	1,074,340
Fire services	52,915	273,740	221,905	216,830
Gasworks	157,400	94,970	196,500	279,650
Abattoirs	54,600	2,500	23,300	33,000
Machinery	82,495	37,410	89,650	124,920
River works and flood damage	27,250	219,900	405,590	68,600
Auckland Harbour Bridge	..	..	5,002,000	..
Miscellaneous	628,700	477,575	780,200	585,700
	13,891,297	17,853,560	23,982,810	25,818,955

206. Recurrent difficulties have faced local bodies since 1951 in raising the finance which they require to carry out works. The smaller local bodies have had particular difficulty, and special problems have arisen in the Auckland urban area, where the demand for loan money has been very heavy.

207. According to the Loans Board, until towards the end of 1951 local bodies had for many years been able to get their loan finance in the main from institutions – particularly from the insurance companies, but also from the State lending institutions, the trustee savings banks, etc. –

all of which were prepared to invest substantially in local body debentures. Some local bodies elected to borrow by selling debentures of small denominations to the general public and they did so without great selling expense. Before 1951 (and indeed well back into the pre-war years) local bodies were able to borrow the moneys needed to finance their capital works programmes without any difficulty, except for a short period about the beginning of the last war. However, 1951 saw a gradual tightening of the loan market arising from increasing demand, and local bodies experienced corresponding difficulty in obtaining their requirements. Indeed, in the early part of 1952, a virtual stalemate was reached.

208. The rate of interest which local bodies were permitted to offer was raised in August 1952, but apart from a short period in late 1953 and early 1954, when there was a temporary easing of the demand for credit by the private sector, local bodies have continued to find the market for their securities difficult. For instance, the following table shows that, despite an increase in the amounts approved by the Local Government Loans Board, the total of loan moneys actually raised declined in 1954–55:

(£ million)

—	Loan Moneys Raised	Loans Sanctioned	
		Works	Redemptions
1952–53	11·6	17·9	0·2
1953–54	16·6	24·0	0·3
1954–55	15·4(1)	25·8	0·4

(1) Provisional

209. To help to meet the position, the Board in 1955 authorised the reintroduction of the practice of underwriting local body loans, the fee permitted being 10s. per cent. The maximum rate of interest was also raised again in October 1955.

210. The main reason for the difficulties faced by the local bodies appear to be that increases in interest rates approved for local body loans have not been in line with increased returns available from other avenues of investment. As a consequence, local bodies have not obtained as much as they would have wished from some of the institutions to which they have traditionally looked for funds. For instance, although insurance companies, the main source of local body finance, increased their holdings of local body securities by about £7 million between 1950 and 1955, they increased their holdings of mortgages by nearly £40 million. Before the war, insurance companies' holdings of local body securities were about double their holdings of mortgages – but, in 1955, their holdings of mortgages were nearly £25 million greater than their holdings of local body securities. The Public Trustee has also preferred mortgages to local authority debentures since 1950 and has actually reduced his holdings of the latter.

211. The Government has attempted to alleviate the position by making more funds available to the local bodies through the National Provident Fund and the State Advances Corporation, and the trustee savings banks

have increased their holdings by nearly £3 million since 1950. But, in general, it is clear that the terms of local body loans have been insufficiently attractive to institutional investors.

212. As a consequence, local bodies have had to rely heavily on private investors for their requirements. This is indicated by the following table showing sources of funds borrowed by local bodies during the year ended 31 March 1955 under some of the loan authorities issued during that year:

	£
Private investors(1)	5,552,320
Insurance and trust companies(2)	1,234,895
National Provident Fund	747,200
State Advances Corporation	273,040
Other companies	167,200
Other local authority funds(3)	120,000
Other sources	104,950
	£8,199,605

(1) Includes some public issues which do not show the various sources of the moneys and may include some investments by companies, etc.

(2) Includes insurance companies, savings banks, trustee companies, building societies, and trading-bank investments.

(3) Sinking funds, depreciation funds, etc., of other local authorities.

213. The foregoing statistics cover only a little over half the full amount borrowed by local bodies during the year, but they are sufficiently comprehensive to indicate the relative importance of the various sources contributing to local body loans at the time.

214. To attract the small investor in a period of inflation, local bodies have found it necessary to offer debentures covering a much shorter term than they have been accustomed to offer in the past. This, of course, will involve them in arranging for refinance of many loans at comparatively short intervals.

215. Two other, relatively minor, sources of loan finance for local bodies should be mentioned. Firstly, there has been some pooling of temporary surplus loan moneys. In November 1955 the Government announced that the Investment Committee established to control the National Provident Board's funds would also be authorised to control a pool of local body funds that could be lent to other local bodies. This proposal apparently replaces and extends the previous activities of a private sharebroker who had been of "considerable assistance", according to the Secretary to the Treasury, in carrying out a limited function of this nature.

216. Secondly, local bodies with rating powers may borrow within limits on overdraft, and in March 1955 their indebtedness in this form was £1·5 million.

Private Borrowing

217. It is impossible, without a great deal more information than is at present available, to provide an adequate account of the structure of private indebtedness in New Zealand, or to trace the changes which have taken place since 1934. We make suggestions in our report as to statistics which might be collected and research which might be done in this field. In this appendix we can do no more than give some indication of the trend of private indebtedness and discuss briefly some of the problems which have arisen or persisted during the period under review.

218. Probably the best indication of the general trend of private indebtedness during the period is given by the following figures of loans made by various financial institutions:

Loans of Various Financial Institutions to the Private Sector

(£ million)

—	As at 31 March				
	1934	1939	1946	1950	1955
State Advances Corporation mortgages and industrial loans	42·5	51·6	47·4	75·0	117·6
Insurance companies—					
Mortgages(1)	8·2	11·6	12·5	18·7	58·1
Loans on policies(1)	6·0	5·5	3·8	3·6	4·2
Public Trust Office mortgages ..	13·2	11·8	9·8	9·1	13·4
Building societies: Loans	8(2)	10(2)	12·1	16·3	26·6
Trustee savings banks mortgages ..	5·9	7·0	6·8	8·1	13·6
Government Superannuation Funds: Mortages	3·2	2·6	1·9	0·8	0·4
National Provident Fund: Mortgages(1)	1·3	1·1	0·8	0·7	1·0
Trading-bank advances and discounts(3)	41(2)	55·5	58·0	96·1	189·3
	129(2)	157(2)	153·1	228·4	424·2

(1) End of previous December.
(2) Approximately.
(3) Last balance day in March.

219. It should be stressed that this is by no means a complete coverage of private borrowing (e.g., it excludes sales on credit terms by all types of business and loans by a number of financial institutions (mostly small) and by individuals or firms). But the table gives a fair indication of the general trend of private borrowing.

220. It will be noted that, as the country emerged from the depression between 1934 and 1939, private indebtedness to the institutions covered by the table rose by between a fifth and a quarter. There were two major causes of the rise:

(a) The community became increasingly indebted to the trading banks as the level of economic activity increased, making it necessary for firms to increase their working capital; and

(b) The better economic conditions led to a greater demand for housing and farm properties, necessitating greater recourse to institutions providing mortgage finance.

221. During the war, loans of the institutions covered in the table to the private sector declined slightly, increased loans to some people and firms being more than offset by repayments by others. Shortages of labour and materials and various controls restricted private expenditure, and surplus funds were directed primarily to the Government for war purposes.

222. Between 1946 and 1950, with expansion of business, settlement of servicemen on farms, and a greatly increased demand for housing, private indebtedness to these institutions rose by about 50 per cent. But a more spectacular rise of about 86 per cent occurred between 1950 and 1955, when loans of these institutions increased from £228 to £424 million. A major influence here was a sharp rise in prices of land and property, as controls on their sale were lifted under prevailing conditions of inflation and rising population. Moreover, despite higher costs, farmers and business firms were anxious to expand their assets to take advantage of the sellers' market which has persisted, with occasional minor set backs, up till the time of writing.

223. Private borrowers may be classified into four main groups, viz. (a) industry and commerce, (b) farmers, (c) individuals requiring finance for housing, and (d) individuals requiring finance for various consumer goods. It is proposed briefly to comment on borrowing and the sources of loan money for each of these groups.

Industry and Commerce

224. A new firm starting business or a firm which requires money to expand its plant or equipment or to maintain or expand its stocks has several alternatives open to it. It may obtain long-term finance:

(a) By selling ordinary or preference shares to existing owners or to outsiders.
(b) By retaining in the business sums which it could otherwise pay as dividends to shareholders.
(c) By issuing mortgages and debentures as security for loans by individuals or financial institutions.

It may obtain short-term finance:

(a) By obtaining loans on overdraft from a trading bank.
(b) By arranging loans from its suppliers or customers or by deferring payment of its suppliers' accounts.
(c) By accepting deposits from customers.
(d) By deferring payment of its taxes (and thus incurring the penalty involved).

225. It is impossible to determine how New Zealand business firms have financed their expansion in recent years, but the following information may be helpful as a background to discussion of the problems of providing adequate industrial and commercial finance in this country.

226. A striking characteristic of New Zealand business is the small size of the average business unit and the relative importance of private companies and individually-owned enterprises as units of business organisation. For instance, in 1952–53 only about 10 per cent of the factories and 3 per cent of the retail stores were operated by registered public companies. The small size of the average New Zealand factory is indicated by the following figures:

Averages of Factory Statistics, 1953–54

	Average Per Establishment
Persons engaged	17
Added value	£19,317
Value of premises and plant—	
Land and buildings	£8,349
Plant and machinery	£6,286
Capital Expenditure during year 1953–54 ..	£2,289

227. Even in terms of nominal and paid-up capital, the private companies as a group have, due to their increasing numbers, been overtaking the public companies, as the following table shows:

(£ million)

—	Private Companies			Public Companies		
	Number	Nominal Capital	Paid-up Capital	Number	Nominal Capital	Paid-up Capital
1932	6,083	48·4	[1]	1,732	97·6	59·1
1938	7,399	55·8	49·3	1,626	100·2	64·9
1947	11,358	87·0	77·8	1,381	106·4	73·2

[1] Not available.

228. Although no statistics are available to show how the individually owned enterprises and private companies have financed their expansion in recent years, it is generally agreed that they have relied fairly heavily on retained profits and on short-term finance, especially on bank overdrafts, not only for working capital, but also for purchase of plant and equipment. They have been fortunate in facing a sellers' market which has enabled them to "plough back" substantial sums into the business, but it has proved difficult for small firms to secure long-term finance from other sources.

229. Small firms cannot issue shares to the public through the Stock Exchange and must rely for borrowed funds on private individuals or firms, or on financial institutions. There has been an increasing tendency for life insurance companies to turn to commercial and industrial mortgages as an avenue of investment in the last few years. One company, holding about 45 per cent of the total mortgages held by life insurance companies in December 1954, had commercial and industrial mortgages totalling nearly £10 million at that date. Finance companies also provide a certain amount of capital, mainly for a medium term. We have no information on the proportion of the funds advanced by these institutions which has been made available to smaller concerns.

230. Some information is available on the finances of public companies as a result of a survey by the Reserve Bank of the accounts of 203 public companies for the years ending June 1953 and 1954. The following table prepared from information supplied by the Reserve Bank compares the structure of their liabilities and assets with those of companies surveyed in a few other countries:

Comparison of Company Financial Statement Structure Between New Zealand and Other Countries

	New Zealand		United Kingdom		Canada	Sweden	India
	1953	1954	1953	1954	1953	1953	1951
LIABILITIES							
	Per Cent	Per Cent	Per Cent	Per Cent	Per Cent	Per Cent	Per Cent
Bank overdrafts and loans ..	12·81	10·26	4·69	4·81	4·20	25·48	21·89
Creditors, etc.	16·61	17·55	22·66	22·04	10·67		11·43
Future taxation	3·91	3·69	5·78	5·79	3·68		7·34
Current liabilities (total) ..	33·33	31·50	33·13	32·64	18·55	25·48	40·66
Debentures and mortgages ..	10·80	11·45	11·37	11·54	17·98	22·14	3·98
Outside interest in subsidiaries	0·67	0·62	1·76	1·66	..	..	..
Long-term liabilities (total) ..	11·47	12·07	13·13	13·20	17·98	22·14	3·98
Preference capital.. ..	5·69	5·73	9·33	8·77	5·34	52·38	34·92
Ordinary capital ..	30·59	30·96	19·74	20·07	22·72		
Capital reserves	2·29	1·88	7·19	6·63	35·41		20·45
Revenue reserves and carried forward ..	16·63	17·86	17·49	18·70			
Shareholders Funds (total)	55·20	56·43	53·75	54·17	63·47	52·38	55·37
Total liabilities ..	100	100	100	100	100	100	100
ASSETS							
Cash, etc.	1·06	1·47	9·28	10·39	5·11	32·73	6·29
Debtors	15·75	16·52	16·62	17·07	12·46		21·78
Stocks	29·45	25·61	28·90	27·56	23·57	16·64	34·58
Current assets (total) ..	46·26	43·60	54·80	55·02	41·14	32·73	62·65
Total Investments	17·73	19·31	13·67	12·50	11·35	..	6·01
Fixed Assets: Land, property, and plant	36·01	37·09	31·53	32·48	47·52	50·63	31·35
Total assets	100	100	100	100	100	100	100

Sources:
United Kingdom: Economist; statistics of 537 companies.
Australia: Australian Financial Review; statistics of 373 companies.
Canada: Bank of Canada Bulletin; statistics of 704 companies.
Sweden: Skandinaviska Banken; statistics of about 70 large companies.
India: Reserve Bank of India; statistics of 757 companies.
New Zealand: Reserve Bank of New Zealand; statistics of 203 public companies.

231. The Reserve Bank in submitting the above table made the following comments:

The figures are not absolutely comparable for the following reasons. There are substantial differences in economic and financial policy and structure of the countries concerned which naturally have a bearing on the type of industry carried on and in the analysis of company balance sheets generally. Although the number of companies making up each country survey is given, the methods of compilation are not known in all cases nor do we know how representative a sample each overseas company analysis comprises. The New Zealand statistics probably show a slightly better financial position than is the overall general company situation. No private companies are included in the survey and nearly 90 per cent of New Zealand companies are private concerns, the majority of which are relatively small.

232. The Reserve Bank also supplied the following interpretation of the data in the table:

(1) The predominant differences in the figures submitted show that companies in overseas countries, with the exception of India, rely less on bank overdraft and other short-term borrowing than New Zealand companies. They do, however, use long-term mortgage and debenture capital and retained profit reserves more.

(2) The more fully developed capital market in overseas countries probably explains the higher percentage of capital funds obtained from long-term borrowed money against fixed asset holdings in the case of all overseas countries shown excepting India.

(3) The higher percentage of funds obtained through sundry short-term creditors in the United Kingdom, compared with that for other countries shown, is offset by higher percentage figures in cash balances and in debtors.

(4) United Kingdom firms appear to have a higher turnover and stock-turn on approximately the same shareholders' funds percentage figure as other countries in the survey. Because of higher business activity greater liquid balances are required.

(5) In spite of the higher stock-turn figures, net profit after tax is a lower percentage of shareholders' funds in the United Kingdom than in the other countries surveyed. This is probably explained by the profit mark-up being lower through competition or because higher percentage taxes take more of profit than in other countries.

(6) The better working capital position of companies in all the overseas countries surveyed, except Sweden, is particularly noticeable.

(7) The break-up of shareholders' funds, particularly the high proportion held by New Zealand companies in ordinary shares and the lower percentage owned in preference capital and reserves is probably explained by the fact that in other countries industries have been longer established thus enabling the building up of reserves and with the addition of an unpegged interest rate making preference shares more attractive to the cautious investor.

(8) The proportion of funds held in stocks amongst the countries calls for little comment except in the case of Sweden where the figure is very low perhaps because of the nature of many of the companies included in their survey, all of which are large firms. For example, pulp and paper companies appear to carry only a small proportion of their assets in the form of stocks, whilst a high percentage is tied up in fixed assets as is the case with most firms in heavy industry.

(9) The generally higher percentage of funds held in the form of fixed assets in the countries other than New Zealand and the United Kingdom may be due to the fact that, in our own case, secondary industry is predominantly light industry. A possible explanation for the United Kingdom's low fixed assets percentage figure may be fairly extensive use of the method known as "sale and lease back" where large firms sell their land and buildings to big financial institutions which in turn grant long-term leases to the vendor company. In addition, the tremendous spurt in the consumer goods industries since the war in the United Kingdom will have caused a reduction in the fixed asset percentage figure. A higher stock-turn figure reinforces this argument.

233. Some companies operating in New Zealand have overseas affiliations and receive financial assistance from them. The assistance may take the form of remittances of cash, or the provision of capital assets without corresponding payment, or the reinvestment of profits earned in New Zealand by overseas companies. The Department of Statistics has, since 1950, undertaken an annual survey of companies with overseas affiliations, from which were obtained the following figures of annual increases of investment capital in New Zealand branches and subsidiaries of overseas companies:

Overseas Private Direct Investment in New Zealand

(£ million)

——	1950–51	1951–52	1952–53	1953–54	1954–55
Increases in Investment (1)	6·7	12·4	9·7	1·6	11·4

(1) Includes: (a) Remittances of cash to New Zealand; (b) imports into New Zealand of plant and machinery and commercial stock not paid for by the New Zealand affiliate; (c) dividends declared but not remitted to Head Office; (d) profits retained in New Zealand.

Borrowing by Farmers

234. Especially from 1950 onwards, the demand for farm property has been very high, and farm properties have changed hands at greatly increased prices. This has led to an increasing demand for mortgage finance by potential farmers, as indicated by the following figures:

Mortgages Registered on Country Properties

Year Ended 31 March	Amount Secured on Mortgages Registered During Year
1934	3·8
1939	8·6
1946	8·5
1950	13·4
1954	28·6

235. The main institutional sources of mortgage finance for farm properties have been the State Advances Corporation, the insurance companies, and the Public Trust Office. The following table shows changes in the rural mortgages held by the State Advances Corporation and the Public Trustee and by the largest life insurance company in New Zealand in four years since 1939:

Holdings of Rural Mortgages

(£ million)

As at 31 March	State Advances Corporation	Public Trust Office	A.M.P. Society
1939	25·5	(1)	3·2(2)
1946	23·6	(1)	3·3(2)
1950	36·6	7·0	3·8(2)
1955	50·5	6·8	8·7(3)

(1) Not available
(2) Figures for 31 December
(3) December 1954

236. The mortgages of the State Advances Corporation include loans made to ex-servicemen at low rates of interest under the Rehabilitation Act. Of course, a large number of mortgages would be negotiated privately or through solicitors, but no figures are available to show the holdings of these. Farm mortgages are an important aspect of the business of the Invercargill Savings Bank – their holdings were £988,000 as at 31 March 1955.

237. For short-term finance, farmers rely heavily on the trading banks and on stock and station agency firms. The following figures show advances by trading banks to farmers as at the end of March of the years concerned:

Trading-banks' Advances to Farmers

End of March—	£ million	End of March—	£ million
1939	18·5	1954	24·6
1946	19·3	1955	29·3
1950	17·3		

238. Particulars of advances to farmers by stock and station agency firms are not available, but the Secretary of their Association estimated, in evidence before the Commission, that they would be not less than £20 million at that time.

Finance for Housing

239. The value of dwellings erected annually in New Zealand has risen from £1·3 million in 1933 to £7·5 million in 1939, £20·8 million in 1950, and £40·2 million in 1955. This expansion of the value of buildings constructed, in conjunction with an increasingly rapid transfer of existing properties at rising prices, has led to a marked increase in the demand for mortgage finance for the erection or purchase of dwellings.

240. The following table shows the residential mortgages held by the major institutions providing such finance at various dates during the period under review:

Investments of Various Institutions in Residential Mortgages

(£ million)

—	As at 31 March				
	1934	1939	1946	1950	1955
State Advances Corporation: Urban mortgages(1)	(2)	26·1	23·8	38·4	65·6
Building societies: Loans	8(3)	10(3)	12·1	16·3	26·6
Trustee savings banks: Mortgages(4)	5·9	7·0	6·8	8·1	13·6
Public Trustee mortgages on dwellings or flats	(2)	(2)	(2)	3·8(3)	4·2
A.M.P. Society, city and suburban properties(5)	(2)	1·0(6)	1·4(6)	5·9(6)	17·0(7)

(1) Figures for 1939, 1946, and 1950 include industrial loans, probably of between £1 million to £1½ million.
(2) Not available.
(3) Approximate only.
(4) Includes some farm mortgages, probably not exceeding £1½ million in 1955.
(5) Includes commercial and industrial mortgages, which would be an increasing proportion of the total at later dates. As at 31 December 1954, residential mortgages were £7 million and industrial and commercial mortgages £10 million.
(6) Figures for 31 December of year concerned.
(7) As at 31 December 1954.

241. A number of other institutions provide mortgage finance for housing (e.g., the other insurance companies and various investment or trust companies) and a considerable amount would probably be arranged privately or through solicitors, but details of amounts lent in these ways are not available. Trading-bank advances for housing purposes (including group housing) were £10·3 million at the end of December 1954 and £7·3 million at the end of December 1955.

242. The State has placed major emphasis on housing and housing construction throughout the whole period under review and, as one aspect of this policy, has taken special steps to make large amounts of loan money available at relatively low rates of interest. The number of loans authorised by the State Advances Corporation on urban mortgages between March 1935 and March 1955 was 89,100, to a total value of £116 million.

243. As a matter of Government policy, two groups have received especially favourable treatment in obtaining loans from the Corporation:

(a) Under the Rehabilitation Act 1941 and its amendments, over 49,000 housing loans totalling £67 million had been made to ex-servicemen and ex-servicewomen up to 31 March 1955, mainly at a rate of interest of 3 per cent (while, incidentally, £5·7 million had also been lent to such persons interest free for the purchase of furniture).

(b) The other group receiving specially favourable treatment has been tenants of State rental houses, who were offered the houses for purchase on generous terms from 1950 onwards. The price of the houses was fixed on the basis of their cost of construction, which in the majority of cases would be well below current costs and market values; for houses built before 1950 a deposit of only 5 per cent of the purchase price was required; a suspensory loan of up to 10 per cent of the purchase price was granted and the balance was payable over terms of up to forty years at a rate of interest of 3 per cent. We were informed by the General Manager of the State Advances Corporation that the sale of these houses, even on these terms, had had a favourable effect on the finances of housing administration as it reduced the annual loss involved in the letting of State houses at low rentals. The accumulated loss up to 31 March 1955 in the revenue account of the Housing Account administered by the Corporation was about £1,166,000. Even in 1955, the current annual deficiency in respect of State rental units was estimated at about £300,000.

244. Loans to persons not eligible for rehabilitation assistance were provided mainly at a rate of $4\frac{1}{8}$ per cent, except in the case of loans for the purchase of existing houses since December 1953 for which the rate of interest has been $4\frac{7}{8}$ per cent. In many cases since 1950, part of the sums advanced has been regarded as a suspensory loan, repayable if the house is disposed of within seven years, but otherwise bearing no interest and being converted into a grant when the seven years have expired. Over £2 million had been advanced on this basis up to 31 March 1955.

245. In the case of purchasing existing houses, loans have normally been limited to two-thirds of the value of the security, up to a maximum of £2,250; for the erection of new houses up to 90 per cent of the value of the security, with a maximum of £2,000, may be advanced. With the sharp rise in building costs and property values in the past five years it is probable that more people than previously have been forced to seek supplementary finance from other sources.

246. A further measure taken by the Government in 1953 in an effort to make housing finance more readily available on first mortgage was a mortgage guarantee scheme, enabling the State Advances Corporation to give a guarantee on behalf of the Government to approved financial institutions in relation to the portion of any loan made to a client in excess of the normal margins and up to 90 per cent of valuation with a total loan limit of £2,200. Over 1,100 home builders had been so assisted up to March 1955, involving the other institutions in loans amounting to £2·4 million, of which the Corporation had guaranteed £420,000.

247. In addition to facilitating the provision of finance for erection and purchase of homes by private citizens, the State has itself undertaken the construction, mainly for letting, of over 50,000 houses since 1937. The cumulative expenditure on the Government's housing scheme since its inception has been over £110 million. This has been financed partly from taxation but mainly from borrowing, the amounts being included in the public debt examined in paragraphs 194 to 196 above.

Borrowing for the Purchase of Consumer Goods

248. Individuals may borrow in various ways to obtain consumer goods, e.g., by obtaining goods on credit from retailers, by using cash orders, by entering into hire-purchase agreements, and so on. Unfortunately, there is not sufficient information available to give any indication of changes in the extent of borrowing of this type since 1934. We understand, however, that the Department of Statistics is currently collecting statistics of this nature.

III. THE SOURCES OF CREDIT

249. Having outlined the main groups which borrow in the credit market, and examined the sources of loan money available to each of them, we now review briefly the operations of the major financial intermediaries mentioned above, and the sources of the money which they lend.

Relative Importance of the Various Financial Institutions

250. The following table gives some indication of the relative amounts of credit extended by major financial institutions and the changes which have taken place since 1934. (For more detailed information see the table in Appendix H):

Loans and Investments in New Zealand of Various Financial Institutions as at 31 March

(£ million)

—	1934	1939	1946	1950	1955	Change 1934 to 1955
1. Reserve Bank(1)	1·5(2)	22·3	34·9	104·8	91·4	+89·9
2. Trading banks(1)	67(3)	65·8	87·1	109·5	215·3	+148(3)
3. Post Office Savings Bank ..	41·9	57·6	145·6	169·2	215·1	+173·2
4. National savings	..	..	35·0	45·7	63·5	+63·5
5. Trustee savings banks ..	10·5	13·3	30·1	40·5	49·5	+39·0
6. Building societies	8(3)	10(3)	13·5	18·0	28·9	+21(3)
7. Insurance companies(4) ..	45·5	52·6	78·4	99·7	151·5	+106
8. Government Superannuation Funds(5)	4·7	5·2	5·0	7·1	16·6	+11·9
9. National Provident Fund ..	3·4	5·3	8·1	10·7	15·5	+12·1
10. Earthquake, etc., Fund ..	..	..	4·7	6·7	12·1	+12·1
11. State Advances Corporation	47·1	57·8	55·2	79·4	125·1	+78
12. Public Trust Office ..	24·0	22·7	23·4	18·3	21·2	−2·8
13. Primary industry reserve accounts	..	..	17(6)(3)	65(6)(3)	82(6)(3)	+82(3)

(1) Figures for last balance day in March except where otherwise indicated.
(2) September 1934.
(3) Approximate only.
(4) Life, fire, accident, and marine companies. Figures for previous December.
(5) Combined Public Service, Teachers, and Railways Funds in 1934, 1939, and 1946.
(6) At end of production year.

251. The main points of interest shown by this table are as follows:

(a) There has been a considerable expansion of lending by practically all the institutions, especially since 1950.

(b) The importance of Government-owned or Government-controlled institutions in the credit market is revealed. The Reserve Bank, the Post Office Savings Bank (with national savings), the Government Superannuation Fund, the National Provident Fund, the Earthquake and War Damage Fund, the State Advances Corporation, and the Public Trust Office are all Government institutions; the Government has a voice in the disposal of the primary industry reserve accounts; it owns a trading bank, which in 1954 did 40 per cent of the advances and deposit business of the trading banks as a whole; and it also owns important life and fire insurance offices.

(c) The Reserve Bank has become an important source of credit to the Government and to statutory marketing organisations.

(d) Trading-bank credit grew relatively slowly up till 1950 and consequently declined as a proportion of the total credit granted by the various institutions. There has, however, been a notable expansion of bank advances since 1950, restoring their position to some extent.

(e) The small savings institutions, especially the Post Office Savings Bank and national savings, received a large accretion to their funds during the war. Their rate of growth has been slower than that of the trading banks and the insurance companies since the war.

(f) The relative importance of the insurance companies declined during the war and early post-war years, but they have recovered their position to some extent since 1950.

(g) The total of loans and investments made by the Public Trust Office has declined. Consequently, its relative importance in the credit market is now less than before.

(h) The wartime and post-war stabilisation schemes led to the setting aside in reserve funds for the primary industries of substantial sums of money which became available for investment, mainly in Government securities.

The Reserve Bank

252. The operations of the Reserve Bank and the trading banks have been examined in the section of this report dealing with the monetary and banking system. Here we shall merely mention matters not dealt with elsewhere.

Management of the Reserve Bank

253. The Reserve Bank was constituted in 1933 as a corporate body with a publicly subscribed capital of £500,000 and a reserve fund of £1 million provided by the State. However, the State appointed not only the Governor and Deputy Governor, but all seven directors of the Bank. The share capital was purchased by the Government in 1936.

254. Management is vested in a Board of Directors consisting of:

(a) A Governor and a Deputy Governor appointed by the Governor-General in Council for terms of seven years:

(b) The Secretary to the Treasury, ex officio:

(c) Up to seven "ordinary members" appointed by the Governor-General in Council during pleasure, but not to hold office for more than five years without reappointment.

255. The legislation provides that there shall be an Executive Committee of the Board, consisting of the Governor, the Deputy Governor, and not less than one other member acting as such by direction of the Board, or with the Governor's concurrence. This Executive Committee is given the power to deal with any matter within the competence of the Board, but every decision of the Committee has to be submitted to the Board for confirmation at its next meeting, to which full minutes of the Committee's proceedings must also be submitted. The duties of the Governor include permanent control of the administration of the assets and general business of the bank on behalf of the Board, with authority to act and to give decisions in all matters not reserved to the Board by rules of the bank or by the Act.

Functions of the Reserve Bank

256. The main functions of the Reserve Bank are to:

(a) Act as banker to the Government, its trading Departments, and certain statutory marketing organisations.

(b) Provide a basis for clearing accounts among the trading banks.

(c) Issue notes and distribute coin.

(d) Control credit in New Zealand.

(e) Maintain adequate reserves of gold and overseas exchange.

(f) Administer exchange control.

(g) Manage the public debt.

(h) Study current economic trends and provide information to the public.

(i) Advise the Government on financial matters.

Relations with the Government

257. The changes which have taken place since 1934 in the legislative provisions affecting relations between the Reserve Bank and the Government are considered in one of the subdivisions of Section Nine of our report.

Trading Banks

Structure and Operation of Trading-bank System

258. There are five trading banks at present operating in the country. The following information about their operations is based largely on data supplied to the Commission by the Associated Banks in New Zealand.

259. Particulars of dates and places of incorporation, dates of commencement of business in New Zealand, paid-up capital, and average shareholding are as follows:

—	Incorporated	Commenced Business in New Zealand	Paid-up Capital	Average Shareholding (in Terms of Paid-up Capital)
Australia and New Zealand Bank Ltd. (In England) ..	1951	1951	£(Eng.) 10,200,000	£(Eng.) 509
Successor to Bank of Australasia (Under Royal Charter)	1835	1864	..	..
The Union Bank of Australia Ltd. .. .. (In England and in New Zealand under New South Wales Ordinance 1839 and New Zealand Private Ordinance 1844)	1837	1840	..	..
Bank of New South Wales .. .. (In New South Wales and incorporated in New Zealand under Bank of New South Wales Act 1861)	1817	1861	£(A.) 13,170,000	£(A.) 810
Bank of New Zealand .. .. .. (In New Zealand)	1861	1861	£(N.Z.) 6,328,125	(1)
The Commercial Bank of Australia Ltd. .. (In Victoria)	1866	1912	£(A.) 5,170,284	£(A.) 421
The National Bank of New Zealand Ltd. .. (In England and 1873 in New Zealand)	1872	1873	£(Eng.) 2,000,000	£(Eng.) 518

(1) Shares held by New Zealand Government.

260. Only a relatively small proportion of the paid-up capital of the four private banks has been supplied by shareholders domiciled in New Zealand.

261. As regards internal policy and general administration, the individual banks are controlled as follows:

Australia and New Zealand Bank Ltd.: By Board of Directors in London with General Manager in Melbourne. New Zealand business controlled by Chief Inspector in New Zealand.

Bank of New South Wales: By Board of Directors and General Manager in Sydney, and Inspector for New Zealand in New Zealand.

Bank of New Zealand: By Board of Directors and General Manager in New Zealand.

The Commercial Bank of Australia Ltd. By Board of Directors and General Manager in Melbourne, and Manager for New Zealand in New Zealand.

The National Bank of New Zealand Ltd. By Board of Directors in London, and General Manager in New Zealand.

262. The countries in which the banks operate and numbers of branches and agencies in New Zealand are as follows:

	Countries	Branches in New Zealand	Agencies in New Zealand
Australia and New Zealand Bank Ltd.	New Zealand ..	119	41
	Australia ..		
	Fiji		
	New Guinea ..		
	Papua		
Bank of New South Wales	New Zealand ..	83	28
	Australia ..		
	Fiji		
	New Guinea ..		
	Papua		
Bank of New Zealand	New Zealand ..	172	171
	Australia ..		
	Fiji		
	Samoa		
The Commercial Bank of Australia Ltd.	New Zealand ..	52	48
	Australia ..		
The National Bank of New Zealand Ltd.	New Zealand ..	83	42
		509	340

263. In addition, all the banks maintain offices in London and have a network of agents and correspondents throughout the world. The New Zealand business of the Australia and New Zealand Bank, the Bank of New South Wales, and the Commercial Bank is only a relatively small proportion of their total business, as the following table shows:

New Zealand Business as a Percentage of Total Business in New Zealand and Australia: Average for Year Ended January 1955

——	Deposits	Advances	Deposits plus Advances
	Per Cent	Per Cent	Per Cent
Australia and New Zealand Bank Ltd.	26·5	25·2	26·0
Bank of New South Wales ..	12·0	10·0	11·2
The Commercial Bank of Australia Ltd.	13·5	13·9	13·7

264. The following tables show the changes in the numbers of the staff of the trading banks and the wages and salaries paid to them since 1930.

Staff Numbers

	Effective Staff		On War Service		Total Staff	
	M.	F.	M.	F.	M.	F.
1930	3,142	253	..	..	3,142	253
1935	3,089	206	..	..	3,089	206
1940	3,132	327	251	..	3,383	327
1945	2,061	1,403	1,185	15	3,246	1,418
1950	3,593	1,331	..	..	3,593	1,331
1955	4,535	2,602	..	..	4,535	2,602

Salaries and Wages Payments

1930	£1,044,000	1945	£1,312,000
1935	£1,049,000	1950	£2,377,000
1940	£1,273,000	1955	£4,474,000

265. In matters of common interest, the trading banks act through an association known as The Associated Banks in New Zealand, which provides a channel through which the Reserve Bank of New Zealand and other bodies may communicate with the trading banks as a whole.

266. The Associated Banks in their submission claimed that the five trading banks operating in New Zealand are completely independent of each other with no interlocking directorates, and that each bank has a long and separate history, is proud of its traditions and standards, and jealous of its individuality. It appears that competition in advertising for accounts is keen, although there is agreement between the banks on the charges which should be made to customers for keeping accounts and on deposit rates, and little, if any, competition in rates charged on advances.

Major Services Provided by the Trading Banks

267. The major services provided by the trading banks are:

(a) The acceptance of deposits from the public, withdrawable either on demand or after a fixed term.

(b) The granting of loans to customers by way of overdraft or of discount.

(c) The provision and maintenance of the current account and cheque system.

(d) The handling of receipts and disbursements in respect of overseas currency transactions.

(e) The arrangement of shipment of produce on producers' own account.

(f) The provision of trade information.

(g) Assistance in the flotation of Government and local body loans and other public share and debenture issues.

(h) The provision of remittances, letters of credit, travellers' cheques, and general information to travellers within and beyond New Zealand.

(i) The provision of facilities for the safe custody of documents and other valuables.

(j) Miscellaneous services, such as making periodic payments for customers, publishing economic and financial information, gold assaying and refining, and acting as attorney for the holding of investments.

Customers' Accounts

268. The number of current accounts (creditor and debtor) on the books of the five trading banks in New Zealand at the end of March 1955 was approximately 497,000, of which about 110,000 were overdrawn. The total value of the debit transactions on these accounts (mainly withdrawals by cheque) for the year ended 31 March 1955 amounted to about £4,577 million, while the number of debit transactions was about 61 million.

269. The following table showing deposits held by the banks indicates the marked fall which has taken place in the relative importance of interest-bearing deposits since the period before the war:

At End of March	Interest-bearing Deposits	Non-interest-bearing Deposits	Percentage of Interest-bearing to Non-interest-bearing Deposits	Rate of Interest on Twenty-four Months Fixed Deposits
	£ million	£ million	Per Cent	Per Cent
1928	26·8 (9 April)	25·7 (9 April)	104	5
1934	39·9	23·5	170	3
1938	33·1	33·6	99	2½
1945	33·1	89·4	37	2
1955	40·0	237·1	17	2

(Weekly returns to Department of Statistics. Government deposits are excluded.)

270. The reader will note the relative popularity of interest-bearing deposits in the depression year 1934, showing that many persons with purchasing power available had little desire to exercise it quickly. The position was very different in 1955.

271. At the end of March 1955, £33·6 million of the interest-bearing deposits had been left with the banks for fixed terms as follows:

	£ million
Fixed—	
For three months	1·5
For six months	4·0
For twelve months	9·6
For twenty-four months	18·5
	£33·6

272. The latest information available to the banks at the time of our hearings showed that 77 per cent of customers with credit current accounts had balances of under £500, and the average credit balance of all current account customers was £625.

273. Regardless of the extent of operations on his account, each customer is charged 10s. per half-year. In addition, charges are made for collecting cheques or drafts on other centres, amounting to 6d. for sums up to £20, and increasing after that by 3d. for every additional £10, with a limit of £2 10s.

274. The following table gives an indication of the relative importance of the trading banks as holders of deposits:

Deposits to Credit of Customers at Certain Financial Institutions

(£ million)

	As at 31 March			
	1934	1939	1946	1955
Trading banks(¹)	63·4	67·0	143·6	297·8
Post Office Savings Bank	44·9	60·7	128·5	215·7
National savings			26·9	68·2
Trustee savings banks	10·8	13·9	27·3	42·8
Building societies	2·3	3·7	4·6	4·4
Trading companies	6·0	5·1	5·5	N.A.

(¹) Includes demand, fixed, and wool retention deposits.

275. The trading banks estimated on the basis of investigation of overdraft accounts of one bank that 58 per cent of the customers with overdraft accounts had limits of under £500 at September 1954. The following are the figures supplied:

Bank Overdraft Limits as at 30 September 1954

Extent of Limit	Number of Accounts
Small, casual, and temporary advances (no formal limit) ..	13,750
Up to £500	44,550
£501 to £1,000	21,175
£1,001 „ £5,000	25,300
£5,001 „ £10,000	2,750
£10,001 „ £20,000	1,200
£20,001 „ £30,000	364
£30,001 „ £50,000	283
£50,001 „ £100,000	227
£100,001 „ £250,000	183
£250,001 „ £500,000	59
£500,001 „ £750,000	19
£750,001 „ £1,000,000	12
Over £1,000,000	6

276. Interest is charged on the actual daily balance of overdrawn accounts.

277. Up till December 1955, rates of interest charged to customers on overdrafts varied within a range of from 4 to 5 per cent. As a general rule, the minimum overdraft rate is confined to concerns handling the country's primary export production (such as dairy companies, meat operating companies, and wool buyers) and to churches, charitable organisations, and local bodies. The average overall rate, i.e., for all overdrafts at all banks for the year to 31 March 1955, was approximately £4 11s. 8d. per cent per annum, as against an average rate of interest permitted by agreement with the Government of £4 15s. per cent per annum. (Note – The permitted average was raised early in 1956 to £5 per cent per annum.)

The Bank of New Zealand

278. The Bank of New Zealand was nationalised in 1945. Even before that time the Government was in a position to exert an influence on the operations of the bank in that since 1898 it had appointed four of the six directors. In 1945, all the private shares were bought by the State and the Minister of Finance was given power to make all the appointments to the Board of Directors. The members are required by the Act to *"have regard to any representations that may be made to them by the Minister of Finance and shall give effect to any decision conveyed to the Board in writing by the Minister"*.

Relative Shares of Business

279. The following table gives some idea of the proportions of the commercial banking business of New Zealand carried out by each of the banks (the statistics are averages of the monthly figures for 1954):

—	Demand Liabilities		Advances and Discounts	
	£ million	Percentage of Total	£ million	Percentage of Total
Australia and New Zealand Bank Ltd.	50·9	21·8	35·5	22·9
Bank of New South Wales ..	31·1	13·3	18·4	11·9
Bank of New Zealand ..	93·3	39·9	61·9	40·0
Commercial Bank of Australia Ltd.	15·8	6·8	10·5	6·8
National Bank of New Zealand Ltd.	42·5	18·2	28·6	18·5
Total	233·6	100·0	154·8	100·0

Savings Banks

280. A substantial proportion of the savings of the people is channelled to the Government, to local bodies, and to private borrowers through savings banks.

281. The main "small savings" institution in the country is the Post Office Savings Bank, which held deposits to the credit of about 1,537,000 customers in New Zealand at the end of March 1955. According to the 1955 *Year-Book*, there were 970 branches of the Post Office Savings Bank throughout the country, 172 being ledger offices providing demand withdrawal facilities. About 95 per cent of withdrawals were made in this manner, the remainder being made by free telegram or money order, mainly by country depositors who could not attend personally at a ledger office.

282. There are five trustee savings banks, situated respectively in Auckland, New Plymouth, Dunedin, Invercargill, and Hokitika. These held deposits to the credit of over 382,000 customers at 31 March 1955. Withdrawals are normally made by personal application, but the Invercargill Savings Bank permits withdrawal by cheque.

283. The Post Office also conducts a school savings bank scheme. There were 145,000 school accounts open on 31 December 1954.

284. The National Savings Act 1940 made provision for the issue of savings bonds, in denominations of £1, £10, and £100, and the opening of special savings accounts with the Post Office and the Auckland, New Plymouth, Dunedin, and Invercargill Trustee Savings Banks. Investments in bonds are for a period of five years, and in the savings accounts for two years, though releases can be obtained in cases of hardship or emergency.

285. The following table shows amounts to the credit of customers in the Post Office and trustee savings banks, national savings, and school savings accounts in selected years since 1934:

Amounts to Credit of Customers in Savings Accounts

(£ million)

As at 31 March	Post Office Savings Bank	Trustee Savings Banks	National Savings	School Savings
1934	44·9	10·8	..	..
1938	63·1	13·3	..	0·05
1946	128·5	27·3	26·9	0·2(1)
1950	171·0	34·9	47·7	0·3(1)
1955	215·7	42·8	68·2	0·7(1)

(1) Previous December.

286. The following is a classification of the balances in Post Office Savings Bank accounts at 31 March 1955, showing the number of accounts within the stated limits and the percentage of total accounts within each group:

—	At 31 March 1955	Percentage of Total
Under £1	354,535	23·06
£1 and under £10	368,070	23·94
£10 " £50	289,714	18·85
£50 " £100	123,786	8·05
£100 " £200	125,955	8·19
£200 " £300	70,734	4·60
£300 " £400	45,777	2·98
£400 " £500	36,952	2·40
£500 " £600	27,347	1·78
£600 " £700	16,486	1·07
£700 " £800	12,367	0·81
£800 " £900	10,059	0·66
£900 " £1,000	8,299	0·54
£1,000 " £1,500	23,897	1·56
£1,500 " £2,000	11,022	0·72
£2,000 " £3,000	9,217	0·60
£3,000 " £4,000	1,828	0·12
£4,000 " £5,000	674	0·04
£5,000 and over	487	0·03
Total number of accounts	1,537,206(1)	100·00

(1) Excludes 17,343 accounts domiciled at Apia and Raratonga.

287. The value of national savings bonds sold and redeemed each year since 1940–41 is given in Table 41 in Appendix H. About £9·6 million was raised in this way between 1940 and 1946, but since then redemptions have heavily outweighed the value of bonds sold.

288. The following figures indicate the value of new deposits in and withdrawals from the main savings institutions in the March year 1954–55 (figures for other years are to be found in Tables 38 to 40 in Appendix H):

Value of Deposits and Withdrawals, 1954–55

——	Deposits	Withdrawals	Ratio of Withdrawals to Amounts to Credit of Customers as at March 1954
	£ million	£ million	Per Cent
Post Office Savings Bank ..	117·9	112·8	55
Trustee savings bank ..	26·9	26·2	64
National savings	11·1	10·3	16

289. The last column of the above table shows the relationship of the withdrawals made during the year in each type of institution to the amounts standing to the credit of customers at the beginning of the year. It is interesting to compare these figures with figures showing the relationship between amounts available to trading-bank customers at March 1954 and the value of debit transactions during the following year. Since cheques may be drawn against unexercised overdraft limits we include these among the amounts standing to the credit of customers in the following table:

Total Deposits, End March 1954 (a)	Total Deposits + Unexercised Overdraft Authorities, End March 1954 (b)	Value of Debit Transactions April 1954 to March 1955 (c)	Ratio of (a) to (c)	Ratio of (b) to (c)
£ million	£ million	£ million	Per Cent	Per Cent
282·3	385·8	4,577	1,621	1,186

290. Comparison with the figures for the savings banks gives a striking illustration of the relative rates of turnover of the sums standing to customers' credit at the different institutions. Sums lodged in the savings banks, although repayable on demand, tend to remain there for a relatively long period; sums lodged in trading banks are, in the main, intended for use in the very near future.

Restrictions on Trustee Savings Banks

291. Certain restrictions are imposed on the expansion of trustee savings banks by section 5 of the Trustee Savings Bank Act of 1948. The cities and boroughs where trustee savings banks may operate are stipulated to be the five places now served by such banks, and it is laid down that no bank shall establish any new branch office or agency more than twenty-five miles from its head office.

292. The 1948 Act required the trustee savings banks to hold not less than 40 per cent of their investments in the form of Government stock up till 1 April 1954, when the requirement was raised to 50 per cent. They are also required to keep a sum not less than 5 per cent of their depositors' balances in cash in hand or on current account at a trading bank.

293. In section 30 of this Act, the State guarantees the repayment of deposits held by the trustee savings banks.

294. The maximum rates of interest which may be allowed on deposits are fixed by Order in Council for both the trustee savings banks and the Post Office Savings Bank. The rates fixed in recent years are set out in Table 53 in Appendix H.

Investments by Trustee Savings Banks

295. The following figures show the general pattern of the investments of the trustee savings banks at selected dates since 1934. The more detailed figures for 1953 to 1955 in a table in Appendix H show that there are marked differences in the pattern as between the five banks:

Investments of Trustee Savings Banks

(£ million)

—	1934	1939	1946	1950	1955
Mortgages	5·9	7·0	6·8	8·1	13·6
New Zealand Government securities	2·7	3·8	20·7	29·9	30·6
Local authority securities	1·9	2·5	2·6	2·5	5·3
	10·5	13·3	30·1	40·5	49·5

296. The lending on mortgage is primarily for residential purposes, except in Invercargill and New Plymouth, where rural mortgages predominate. The banks do not lend on table mortgage. Most of their mortgages are repayable on demand and, in Auckland, customers may make repayments in multiples of £5 on any quarter day without notice.

297. The majority of the new funds of the trustee savings banks were, by force of circumstance, channelled into Government securities during the war and early post-war period, so that by 1950 nearly three-quarters of their total investments were in this form, as compared with less than 30 per cent before the war. Since 1950, a greater proportion of their investments has been made in mortgages and local body securities, but they still have about 60 per cent of their total investments in Government stock.

298. The sums collected by the Post Office Savings Bank and in national savings and school savings accounts are invested almost entirely in Government or State Advances Corporation stock.

Building Societies

299. Building societies are important sources of finance for those wishing to build or buy houses.

300. The following extract from the *Official Year-Book* for 1955 distinguishes the different types of building society, the respective sources of their funds, and the types of loan made:

A distinction is made between permanent and terminating societies. A permanent society is statutorily defined as one which has not by its rules any fixed date or specified result at which it shall terminate, and a terminating society as one which by its rules is to terminate at a fixed date, or when a result specified in its rules is attained. In practice a terminating society, or a group thereof, closes when every member so desiring has obtained a loan. There is a considerable difference between the two types of societies, the terminating society being a purely co-operative institution belonging to and managed by the members, proprietary interests being discouraged by placing a limit to the number of shares (usually ten) that any member may hold in any one group. There is, however, nothing to prevent a member from holding the maximum number of shares in more than one group. In a typical terminating society contributions are at the rate of 1s. per week per share, each share entitling a member in due course to £200 of loan, with a maximum, until recent years, of £1,200. As £1,200 is not sufficient to meet the needs of the average prospective house owners on present-day costs, there is a tendancy for the limit to be raised. In some groups of the terminating societies the loan maximum is now £3,000. It is these contributions, together with premiums on loans mentioned later, which make up the funds from which loans are made. Loans are made to members both by ballot and by auction, the latter going for the highest premium offered. Security is required for the loans, which are repaid, free of interest, in periods varying from ten to twenty years. The weekly payment of 1s. per share is continued, usually till the end of the group, but sometimes only until the total contributions paid in, plus profits, credited to the shareholder, equal the amount owing on the loan. The shareholder's credit balance is then transferred to extinguish the loan. The profit of the society is derived from premiums on loans sold by auction.

Permanent societies are more in the nature of finance companies, and, while both investors and borrowers must be members, the borrower is frequently merely a nominal member. Investments in a permanent society may be made in either large or small amounts. Capital may be raised by shares with a fixed rate of interest, or subject to dividends varying according to profits. As will be observed from the statistics which follow, terminating societies do not issue capital shares. Bonds, debentures, deposits, and overdraft are other methods of financing. The principal object of a permanent society is to lend money at a profit on land and buildings, either freehold or leasehold. Table mortgages are normally adopted, the usual term of repayment being up to twenty years.

301. The number of borrowers and amounts of loans outstanding at the end of each of the March years 1934, 1939, 1946, 1950, and 1955 were as follows:

Loans of Building Societies Outstanding

Year	Permanent Societies		Terminating Societies		Total	
	Number	Amount	Number	Amount	Number	Amount
		£ million		£ million		£ million
1933–34 ..	9,674	5·20	7,983	2·63	17,657	7·84
1938–39 ..	13,229	7·27	8,024	2·58	21,253	9·86
1945–46 ..	14,780	8·89	8,758	3·59	23,538	12·48
1949–50 ..	15,344	11·04	10,382	5·30	25,726	16·35
1954–55 ..	15,396	14·97	16,777	11·66	32,173	26·63

There has been a notable expansion of lending, especially by terminating societies, since 1950.

302. The extent to which building societies can lend in any year depends primarily on the share contributions which they receive from members, on the excess of deposits with them over withdrawals, and on the extent of repayment of past advances. An indication of the relative importance of these sources of finance is given by the following summary of receipts and payments for all societies for 1954–55:

Receipts and Payments of Building Societies, 1954–55

Receipts	£	*Payments*	£
Share subscriptions	3,326,044	Members' withdrawals ..	748,610
Advances repaid	3,513,092	Advances	6,417,680
Deposits	2,736,251	Management expenses ..	269,815
Interest	686,539	Dividends paid	111,178
Other receipts	698,036	Deposits withdrawn ..	2,506,005
		Interest paid	230,563
		Other payments	785,293
	£10,959,962		£11,069,144

303. The following table shows the liabilities and assets of all building societies combined on the dates concerned:

Liabilities and Assets of Building Societies for Years Ending March

—	1934	1939	1946	1950	1955
	£	£	£	£	£
LIABILITIES					
To shareholders (including reserve funds and undivided profit) ..	5,923,351	6,495,079	8,529,033	13,238,029	23,736,446
Deposits	2,285,874	3,667,846	4,589,615	4,035,617	4,357,998
Appropriations not taken up or in trust	184,621	243,787	463,988	857,184	1,495,648
To bankers and other creditors ..	190,304	348,146	357,954	877,671	1,449,589
Total liabilities	8,584,150	10,754,858	13,940,590	19,008,501	31,039,681
ASSETS					
Advances on mortgage(¹) ..	7,881,372	9,855,075	12,479,437	17,244,136	28,499,228
Other investments and assets ..	429,619	610,048	968,896	1,462,543	2,325,862
Cash in hand and at bank ..	273,159	289,735	492,257	301,822	214,591
Total assets	8,584,150	10,754,858	13,940,590	19,008,501	31,039,681

(¹) Includes balance owing on premiums on loans.

Institutions for Insurance and Superannuation

304. The fact that persons are anxious to insure themselves or their families against the risks of life and death and to make provision for an adequate income in their old age brings large sums of money each year into the hands of the institutions which have been set up to cater for their demands. The institutions, in turn, are anxious to invest the funds which they acquire in profitable but reasonably safe securities, to enable them to provide the maximum degree of protection for their customers at the lowest possible cost.

305. The following figures summarise and show the distribution of the loans which the major institutions in this field had made as at selected dates since 1934:

Loans by Insurance and Superannuation Institutions as at 31 March

(£ million)

—	1934	1939	1946	1950	1955
Insurance companies(1)(2)—					
Mortgages	8·2	11·6	12·5	18·7	58·1
Loans on policies	6·0	5·5	3·8	3·6	4·2
Local authority securities ..	16·3	19·9	23·3	25·7	32·6
New Zealand Government securities	15·0	15·6	38·8	51·7	56·6
	45·5	52·6	78·4	99·7	151·5
Earthquake and War Damage Fund— New Zealand Government securities	..	..	4·7	6·7	12·1
Government Superannuation Funds(3)					
Mortgages	3·2	2·6	1·9	0·8	0·4
Local authority securities ..	0·8	1·1	0·9	0·6	0·4
New Zealand Government securities	0·7	1·5	2·2	5·7	15·8
	4·7	5·2	5·0	7·1	16·6
National Provident Fund(1)—					
Mortgages	1·3	1·1	0·8	0·7	1·0
Local authority securities ..	0·2	0·5	0·4	1·1	9·1
New Zealand Government securities	1·9	3·7	6·9	8·9	5·4
	3·4	5·3	8·1	10·7	15·5
Totals—					
Mortgages	12·7	15·3	15·2	20·2	59·5
Loans on policies	6·0	5·5	3·8	3·6	4·2
Local authority securities ..	17·3	21·5	24·6	27·4	42·1
New Zealand Government securities	17·6	20·8	52·6	73·0	89·9
	53·6	63·1	96·2	124·2	195·7

(1) As at end of previous December.
(2) Life, fire, accident, and marine companies.
(3) Combination of Public Service, Teachers, and Railways Funds in 1934, 1939, and 1946.

306. The most interesting feature of this table is the growth in the relative importance of loans to the Government by this group of institutions, especially up to 1950. Whereas before the war the total of their loans was divided more or less equally among the Government, the local authorities, and private borrowers, 59 per cent of the total in 1950 was in Government securities. Since 1950, as a result of insurance companies directing their funds primarily into mortgages, the private sector has increased its share of the loans made by these institutions while the local authorities' share has remained stable, despite the concentration of the National Provident Fund on local body securities. As at early 1955, about 46 per cent of their loans were in Government securities, 33 per cent in mortgages or loans on policies, and 21 per cent in local authority securities.

307. By far the most important sources of credit among this group of institutions are the life-insurance companies. In 1954, there were fifteen life insurance offices conducting business in New Zealand, including the Government Life Insurance Office. These offices are

organised either entirely on the mutual principle or, in the case of companies having a share capital, the interests of the shareholders are limited. Only four of the offices are purely New Zealand institutions.

308. The growth of life insurance in New Zealand is shown in the following table:

Policies Existing at End of Year

Year	Number	Sum Assured	Annual Premium Income
		£	£
1939	837,453	170,415,223	5,877,652
1946	1,095,583	265,852,607	9,063,972
1950	1,261,054	387,216,172	12,801,138
1953	1,383,709	529,107,427	17,094,440
1954	1,429,756	591,790,390	18,947,766

309. The following table shows the payments made to policy holders arising under claims at death and on maturity of policies in the years stated:

Year—	£	Year—	£
1939	2,943,932	1953	7,105,249
1950	5,474,098	1954	7,398,986

310. The distribution of assets held by the life offices in respect of New Zealand business at the end of 1953 was as follows:

Assets	Amount	Percentage of Total
	£	
Mortgages on property	47,311,935	33·863
Loans on policies	4,103,459	2·937
New Zealand Government securities	42,101,216	30·133
Securities of other Governments	1,797,369	1·286
Local authority securities	30,929,187	22·137
Landed and house property	3,426,941	2·453
Other investments	5,469,705	3·915
Outstanding premiums	943,440	0·675
Interest accrued, etc.	1,149,414	0·823
Cash	1,082,475	0·775
Other assets	1,402,097	1·003
	139,717,238	100·000

311. The detailed Table 47 in Appendix H shows changes in the distribution of the assets of life insurance companies since 1928. Loans to the private sector in the form of mortgages and loans on policies were a high proportion of total assets (43 per cent) in 1928, but fell proportionately during the thirties to about one-third of total assets. Total lending to the private sector remained fairly stable during the war, while lending to the public sector increased considerably, and by 1946 loans on mortgage and on policies were only about 20 per cent of total assets. Since then, and particularly since 1950, funds lent to the private sector have ex-

panded considerably, and represented nearly 40 per cent of total assets in December 1954. Changes in the type of mortgage taken up by the largest company since 1939, together with a break-up of mortgages on city and suburban properties as at December 1954, are given in the following table:

Mortgages on Property – New Zealand Business Analysis According to Type of Security: Australian Mutual Provident Society

Date: 31 December	Farm Properties		City and Suburban Properties		Total	
	Number	Amount	Number	Amount	Number	Amount
		£		£		£
1939	404	3,208,801	270	983,276	674	4,192,077
1946	528	3,304,354	422	1,351,448	950	4,655,802
1950	780	3,788,049	2,134	5,908,133	2,914	9,696,182
1952	1,162	6,081,876	3,431	12,641,544	4,593	18,723,420
1953	1,339	7,171,496	3,636	14,635,138	4,975	21,806,634
1954	1,537	8,650,986	4,405	17,005,604	5,942	25,656,590

—	Farm		Home Purchase		Commercial and Industrial		Total	
	Number	Ledger Balance	Number	Ledger Balance	Number	Ledger Balance	Number	Ledger Balance
		£		£		£		£
1954 ..	1,537	8,650,986	3,911	7,041,574	494	9,964,030	5,942	25,656,590

312. The growth of the relative importance of urban mortgages, especially since 1950, and the predominance of commercial and industrial mortgages as at 31 December 1954 are noteworthy features.

313. Lending to local authorities expanded markedly in the 1930's, and as a result local authority securities rose from 14·5 per cent of life insurance companies' assets in 1928 to over 39 per cent throughout the thirties.

314. However, during the war, the bulk of the companies' funds for investment were directed to Government securities, and since the war, and particularly since 1950, they have found mortgages a more attractive investment than local authority securities. Consequently, by December 1954, local authority securities comprised only about 20 per cent of their total assets.

State Advances Corporation

315. The following information on the operations of the State Advances Corporation has been compiled largely from a statement made to the Commission by the Managing Director of the Corporation.

316. The New Zealand Government set up an Advances to Settlers Department as early as 1894 to provide loans on mortgage to settlers for land-development purposes at economic interest rates and on stable terms and conditions. The Department later became the State Advances Department and extended its functions, particularly into the provision of finance for housing.

317. The report of the Superintendent in 1933 stated that from the inception of the Office in 1894 until that year nearly £75½ million had been advanced of which £31½ million had been repaid. At that time, however, loans were very restricted and many mortgagors were in difficulties which, of course, was the experience also of other financial institutions.

318. Following a survey of economic conditions and the existing mortgage situation at that time, the Government came to the conclusion that in addition to the mortgagors' relief legislation, the need was also established "for organising mortgage finance on a more comprehensive basis – thereby strengthening this part of the financial structure of the Dominion". The result was the establishment in 1935 of the Mortgage Corporation of New Zealand. The original capital was fixed at £1 million in £1 shares of which 500,000 were in terms of the Act allotted to the Crown and the remainder offered for public subscription. Provision was also made for the issue of bonds, stock, or other securities.

319. However, in July 1936 – following a change of Government – the constitution of the Mortgage Corporation was altered. The name of the institution was changed to the State Advances Corporation, and the private share capital of £500,000 was purchased by the Government. The Board was reconstituted to comprise two joint Managing Directors (to function as Chairman and Deputy Chairman), the Secretary to the Treasury, and two other directors appointed by the Government. In 1951 the constitution of the Board was again altered to comprise the Managing Director and a Deputy Managing Director (who function respectively as Chairman and Deputy Chairman of the Board), the Secretary to the Treasury, and other directors (at present three) appointed by the Government.

320. The principal business of the Corporation was restated as *"the making of loans in accordance with the provisions of the principal Acts – as amended – with a view to giving effect to the policy of the Government in that respect as communicated to it from time to time by the Minister of Finance"*.

321. Important extensions were made also on the following lines:

(a) Securities issued by the Corporation were to be State guaranteed.

(b) Restrictions on the borrowing powers of the Corporation were removed.

(c) The Minister of Finance was given power to require the Corporation to redeem Corporation stock held by the Crown from time to time.

(d) Loans approved by the Corporation in excess of two-thirds of the value of the security were to be State guaranteed.

(e) Consent of the Corporation was made necessary to validate any second or subsequent mortgages.

(f) Provision was made for loans for the development of any industry within New Zealand or for the establishment of any new industry. Loans were to be approved as to terms and conditions by the Minister of Finance and guaranteed by the State.

(g) The Corporation was empowered to undertake inspections of properties and other works for Departments of State.

322. Over the period of the twenty years ended March 1955, loans authorised on mortgage were:

89,100 urban for	£116 million
19,500 rural for	£72 million
108,600	£188 million

323. The loan authorisations for the financial year 1954–55 (included in the above figures) in these two main classes were:

Rural: 1,400 for approximately £6 million.
Urban: 8,700 for approximately £15 million.

324. Depending to a certain extent on seasonal effects on rural accounts, the repayments of principal over the last five years varied between £8 million and £10 million. These sums were, of course, available for relending.

325. The Corporation's policy has been to use sparingly the provisions permitting loans to industry. The loans made have been in the main for development and expansion of business activities, which were important from a national viewpoint, but for which the promoters were unable to obtain finance through normal channels.
Examples are:

(a) Loans to manufacturers co-opted during the war to provide munitions, specialised equipment, and goods required by the Army and other phases of wartime operations.

(b) Loans to the farming industry to expand production, i.e., cost of conversion of butter factories to cheese to fit in with the requirements of the United Kingdom.

(c) Finance for organisation and establishment of milk-pasteurisation factories in the main centres and certain aspects of the fruit industry.

326. However, the total amount advanced was only a little over £2 million. The need for much further activity in this section is said by the Corporation to be not apparent at present.

327. The Corporation acted as agent for and on behalf of the Rehabilitation Board, and the figures to the end of 31 March last revealed the following broad classification and number of rehabilitation loans authorised:

—	Number	Amount
		£
Tools of trade	1,470	48,600
Furniture	61,170	5,731,000
Business	11,170	7,241,000
Miscellaneous	660	131,300
Housing	49,180	67,284,000
Farms	10,600	57,400,000

328. These loans carry special concession rates of interest, the difference between these and the Corporation rates being recovered from Treasury. The Treasury provides the funds interest free from which suspensory loans are granted. These suspensory loans are made for new houses, or, after the repeal of the Land Sales Act, for farms acquired by ex-servicemen. (The figures shown for housing and farm loans are included in the total loan authorisations shown previously.)

329. The following table shows the distribution of the Corporation's assets as at various dates since 1934:

	As at 31 March £ million				
	1934	1939	1946	1950	1955
Mortgages—					
Rural		25·5	23·6	36·6	50·5
Urban	42·5	26·1	23·8	38·4	65·6
Industrial loans					1·5
Government and local authority securities	4·6	6·2	7·8	4·4	7·5
	47·1	57·8	55·2	79·4	125·1

330. The Corporation since 1936 has administered the housing units erected under the State rental housing scheme and the associated Housing Account.

331. The Government introduced a plan in 1950 to enable tenants to purchase the houses they occupied. According to the Corporation, this has proved very popular and since the new policy was brought into operation approximately 11,000 units have been sold. The terms of sale were attractive and the effect on the finances of housing administration has also been favourable.

332. Due to a failure to raise rentals sufficiently in the face of rising construction costs, the accumulated loss in the revenue account of the housing administration to 31 March 1955 was calculated by the Corporation to have been approximately £1,166,100, and the current annual deficiency in respect of the State rental units is estimated at approximately £300,000.

333. The majority of the stock issued by the Corporation to obtain funds for lending is held by the Post Office Savings Bank. As mentioned previously, £12 million of its stock was placed with the trading banks in 1954.

The Public Trust Office

334. The Public Trust Office is an important factor in the credit system because it acquires a considerable volume of funds which it invests in the course of its varied operations, e.g., as administrator of intestate estates; executor and trustee under wills; trustee under marriage and other settlements; trustee of benefit or relief funds; agent or attorney for absentees or persons desiring to be relieved of business worries; sinking fund commissioner for local authorities; administrator of unclaimed lands and property; statutory administrator of the estates of mental patients

(other than Maoris) where no committee of the estate has been appointed by the Court; manager (when so appointed by the Court) of the estates of aged and infirm persons unable to administer their own affairs; administrator of compensation moneys payable in respect of the death of a worker (unless the Court orders otherwise); and agent for the investment of certain moneys of the National Provident Fund and the administration of mortgage investments forming part of the Government Superannuation Fund.

335. The following is a classification of the estates and funds which came under administration during the year ended 31 March 1954 and of all estates and funds under administration at that date:

	New Estates and Funds During 1953–54		Estates and Funds Under Administration at 31 March 1954	
	Number	Value	Number	Value
		£		£
Wills estates	2,141	6,467,116	7,708	28,060,188
Trusts and agencies	279	800,616	2,396	10,024,997
Intestate estates	575	591,225	1,625	1,299,844
Mental patients' estates	862	1,824,501	3,908	6,097,239
Miscellaneous estates and funds ..	163	1,277,743	2,377	16,260,271
Totals	4,020	10,961,201	18,014	61,742,539

336. The following table shows the distribution of the investments made by the Public Trustee as at selected dates since 1934:

(£ million)

——	1934	1939	1946	1950	1955
Public Trust Office—					
Mortgages	13·2	11·8	9·8	9·1	13·4
Local Authority debentures ..	7·9	6·8	5·8	4·8	3·2
Government securities	2·9	4·1	7·8	4·4	4·6
	24·0	22·7	23·4	18·3	21·2

337. It will be noted that total lending by the Public Trust Office was lower in 1955 than in 1934. As a result, the office is relatively a less important factor in the credit system than it used to be. There are several reasons for this. The main one is that securities to a value of over £8 million held on behalf of the Public Debt Redemption Fund were withdrawn in 1948. Another reason is the effect of mortgagors' relief and local bodies' conversion legislation in the 1930s.

Farm Industry Reserves

338. A new and important source of credit, particularly for the Government, was developed as a result of the war and post-war policy of stabilising the incomes of meat and dairy producers, and as a result of the

capital profits and other surpluses which accrued to New Zealand through its participation in the Joint Organisation Scheme for the disposal of surplus wartime stocks of wool.

339. The following table shows the growth of the industry reserves since 1942:

Farm Industry Reserves

Balances as at 31 July	Dairy Industry Stabilisation Account	Meat Industry Reserve Accounts	Wool Capital Account(2)	Wool Contributory Charge(3)
	£(N.Z.)	£(N.Z.)	£(Stg.)	£(N.Z.)
1942	..	749,801	..	..
1944	1,066,599	4,317,432	..	..
1947	8,907,459	18,222,140	5,046,287 Dr.	1,165,402
1951	23,037,189	37,255,651 (1)	19,608,187 Cr.	6,166,721
			Wool Commission Capital Account(4)	
			£(N.Z.)	
1952	23,584,778	40,429,379 (1)	26,672,685 (5)	
1953	24,147,261	40,449,822 (1)	27,630,163 (5)	
1954	24,739,485	39,550,761 (1)	28,387,868 (5)	
1955	23,496,481	40,980,000 (1)	29,077,525 (5)	

(1) As at 30 September.
(2) Profits from disposal of wool stocks taken over by Wool Disposal Commission at the end of the war.
(3) This is a levy on all wool sold at auction.
(4) The balances of both the Wool Capital Account and the Wool Contributory Charge Account were transferred to the Wool Commission Capital Account as from 1 January 1952.
(5) 30 June.

340. Most of these funds have been invested in New Zealand Government securities. The Wool Commission holds a small proportion of its reserves in British Government securities. Reserves held in this form have grown slowly over the years to about £1 million in June 1955. The Wool Commission also holds New Zealand Government stock in London to the extent of £2¼ million.

341. The Dairy Products Marketing Commission since 1952–53 has made several loans to dairy factories, but in July 1955 these amounted to only about £714,000 as compared with £14·3 million invested in Government securities. Most of the remainder of the funds in the Stabilisation Account are required as working capital by the Commission.

342. As at 30 September 1955, all the funds in the Meat Industry Reserve Account were invested in Government stock, except for a debenture of £960,000 in a fertiliser company. Some of the funds in the Meat Board's own Reserve Account have been used to make loans on mortgage to aerial topdressing companies, totalling £245,000 in September 1955.

Trading Companies, Finance Companies, Investment Companies, Trustee Companies

343. There is not sufficient information available to enable us to examine the magnitude and direction of the lending and borrowing activities of trading, finance, investment, and trustee companies in New Zealand. It seems most desirable that steps be taken by the appropriate authorities to acquire and publish the statistics necessary to improve knowledge in this field. The activities of these companies in the credit system

are by no means negligible, e.g., the Secretary of the New Zealand Stock and Station Agents' Association estimated that total advances (short and long term) to farmers by stock and station agents was not less than £20 million.

344. Again, trading companies hold substantial sums on deposit. Some indication of the amounts involved can be gauged from the figures supplied to the Treasury up till 1947.

Deposits with Trading Companies as at 31 March
(£(N.Z.))

—	At Call	3 Months and under 2 Years	Two Years or Over	Totals
1934	3,292,740	1,004,031	1,691,344	5,988,115
1935	2,756,187	1,106,836	1,983,391	5,846,414
1936	2,583,167	1,077,754	1,887,648	5,548,569
1937	2,297,438	1,100,109	1,840,630	5,238,177
1938	2,154,307	1,045,739	1,897,136	5,097,182
1939	2,151,353	1,005,715	1,927,142	5,084,210
1940	2,111,470	1,148,445	1,867,442	5,127,357
1941	2,163,558	1,439,932	1,909,233	5,512,723
1942	2,072,634	1,101,813	2,520,567	5,695,014
1943	2,159,064	1,060,844	2,337,672	5,557,580
1944	1,635,665	1,209,096	2,260,818	5,105,579
1945	1,706,039	910,238	2,180,514	4,796,791
1946	2,342,723	1,037,871	2,095,624	5,476,218
1947	2,070,046	784,324	2,136,703	4,991,073

345. The eleven stock and station agency firms surveyed by the Reserve Bank in its analysis of the financial statements of 203 public companies held deposits equal to £5,567,000 in 1953 and £5,797,000 in 1954.

The Stock Exchange

346. The following extracts from the submissions of the Stock Exchange Association outline the role of the Stock Exchange in the New Zealand credit system:

The Stock Exchange is a market place where those who own funds exchange them for stocks and shares and vice versa.

The presence of an open market where the owner of securities may sell them, if at any time he wishes to do so, is a powerful factor in inducing original investment. The Stock Exchange provides for the owner of funds or securities the facilities whereby he may exercise the right to change his mind . . .

Cash is the basis of all transactions and . . . members do not act as bankers for their clients. Operating on "margin" is virtually unknown in New Zealand.

In New Zealand sharebrokers are licensed under the Sharebrokers' Act 1908. There are five recognised Stock Exchanges – Auckland, Wellington, Christchurch, Dunedin, and Invercargill. These five Exchanges are affiliated with the Stock Exchange Association of New Zealand and nominate delegates to attend annual conferences of their body.

Each Exchange manages its own domestic affairs, while the Association formulates rules to maintain uniformity of practice (for example in regard to brokerage and settlement dates) throughout the Dominion. Under the Act those rules of the Association, and also the rules of each Stock Exchange, must be approved by the Governor General in Council and gazetted.

The members of an Exchange have agents throughout the Dominion and overseas who are likewise members of "recognised" Stock Exchanges.

Besides acting in the buying and selling of existing shares, members of the Stock Exchange act as Organising Brokers to new issues and also as underwriters of new issues . . .

Under the rules of the Stock Exchange Association, members may not act in a flotation unless authorised to do so by the Committee of an affiliated Exchange. Such authorisation is given only if the Committee is satisfied that the Prospectus sets out clearly the prospects for the success of the undertaking.

The Stock Exchange also plays its part in assisting the Government in obtaining capital funds. It is believed between 20 per cent and 25 per cent of all subscriptions to Government loans is found by the Stock Exchange Association and that approximately 33⅓ per cent of Local Body securities are placed by the Stock Exchange.

The mainstay of the average sharebroker's business is a substantial number of small orders. This is borne out by a perusal of reported sales in the daily newspaper.

For the purpose of this submission we sought figures to substantiate this statement. One Wellington office advised us that its last fifty (50) buying orders averaged £245.10.0., the largest being £1,047 and the smallest £19.15.11. Another Wellington office has supplied similar figures showing an average of £283.5.8., the largest transaction being £1,006 and the smallest £13.19.9. An interesting feature of these figures was that in the case of the first office 23 of the buying orders were received from women, and in the case of the second office, 14 orders were received from women.

Another Stock Exchange reports that of the last fifty buying orders received from clients (excluding Government Stock) by each of six members of the Exchange, i.e. a total of 300 buying orders, 178 were for £300 or under. The 178 clients were of 52 different occupations as follows:—

Married women	34	Retired	3
Farmers	17	Spinsters	10
Printers	1	School teachers	1
Retired farmers	8	Agricultural inspector	1
Company secretaries	4	Drapers	2
Students	2	Flour millers	1
Clerks	5	Housing inspectors	1
Public accountants	4	Retired army officers	1
Accountants	1	Carriers	1
Company managers	6	Commercial travellers	1
Insurance agents	1	Housekeepers	1
Doctors	7	Florists	1
Dentists	2	Building contractors	1
Engineers	1	Bank officers	4
Journalists	3	Cartage contractors	1
Company directors	3	Retired railwaymen	1
Nurses	3	Woolbuyers	1
Typists	1	Garage proprietors	1
Storekeepers	1	Company representatives	2
Solicitors	8	Farm managers	1
Public servants	9	Contractors	2
Companies	3	Opticians	2
Widows	5	Manufacturers	1
Civil engineers	1	Publishers	1
Electrical engineers	1	Sports Dealers	1
Mechanics	2		
Retired nurses	2		178

Another factor which points towards the interest of the small investor in the share market is that the size of his average shareholdings in companies is decreasing. Figures supplied by three large companies are as follows:

	Average Shareholdings in £1 Units	
	1951	1954
Company X	852	690
Company Y	1,100	800
Company Z	257	248

The apparent discrepancy between the average order mentioned above and the average shareholding given above is explained by two factors, viz.:—

(1) Many of the Dominion's leading companies were at one time private businesses and in most cases there remain a few substantial family holdings which affect the averages.

(2) Many buyers "build up" on their holdings from time to time. This resembles buying by instalments but obviates liability.

It has been found that the small investor is attracted to the share market when "rights" to new issues come on the market. Usually these "rights" are not highly priced and in most cases the investor has the opportunity of meeting the "capital" portion of the payment required over a period of several months.

It has also been found that the small investor with about £100 to outlay will prefer to buy say one hundred shares at approximately £1 each instead of say three shares at £33 each. For this reason our members, whenever opportunity offers, suggest to the Directors of companies the shares of which stand at a high figure that such shares be subdivided in order to reduce the market value of each.

IV. THE PRICE OF CREDIT: INTEREST RATES SINCE 1934

Borrowing Rates

347. Immediately after the depression of the early 1930s interest rates fell appreciably, due to the economic circumstances of the time which produced a heavy dampening of the demand for investment. Government policy was then designed to maintain a cheap money policy as an encouragement to investment, and to stimulate economic recovery. The following is an extract from the Financial Statement of 1933: *"Experts do not altogether agree as to the causes of our troubles, but all are in agreement that cheap money is an essential element of recovery. Accordingly, while endeavouring to give relief for the present, the Government set out upon a campaign to bring about lower market rates of interest on a sound basis. It was considered that, if this could be achieved, it would be of much greater and more lasting benefit to all sections of the community than a simple cut in existing charges".* About that time approximately £115 million of the public debt was converted at lower rates of interest.

348. The 1934 Financial Statement contains a reference to the Reserve Bank which commenced business on 1 August of that year in these terms, *inter alia: "In the immediate future the bank will undoubtedly prove a powerful factor in furthering the Government policy of aiding economic recovery by stabilising interest rates at a lower level".*

349. Government long-term public loan issues between the years 1922 and 1932 were made at rates of interest varying between 5 and 5½ per cent. The conversion loan of 1933 was made in the main at 4 per cent. Subsequent issues between the years 1934 and 1939 were made at 3½ per cent and 4 per cent. Soon after the outbreak of the Second World War, the long-term rate for Government borrowing fell to 3 per cent, and continued at that figure until about 1950.

350. The war years, 1939–45, involved the country in heavy expenditure for war purposes, so that the maintenance of low interest rates for Government borrowing was regarded as a matter of national importance and was supported by patriotic impulses. In this period, fiscal policy was designed to limit the accumulation of private wealth and the interest returns thereon. Early in the war period the economy was subjected to rigid controls. Soon after the end of the war some of these controls were

released, but the majority were continued into the post-war period. The effect of the controls and of shortages of labour, materials, and equipment was to restrain capital expenditure in both the public and private sectors of the economy so that the effective demand for investment was never sufficient to put an undue strain upon the expanding money resources; consequently the general pattern of interest rates was maintained at a low level.

351. It is interesting now to look back at a statement made by the Government Insurance Commissioner in 1951 when, speaking of investments made in the calendar year 1950, he said that he regarded the full employment of the available funds as *"no light achievement in view of difficulties facing investors in a market where there is still no lack of idle money"*.

352. The dismantling of controls from about 1950 coincided with a marked rise in prices for our exports, and produced an unprecedented buoyancy in business conditions. The war and immediate post-war years had left a substantial backlog of desirable capital works which, together with the needs of a rapidly expanding economy, now began to exert heavy pressure upon the available resources, both physical and monetary. The effect on the money market is seen in a rise in the rate of interest on the Government loan issues in 1953 and 1954, from the earlier rate of 3 per cent to $3\frac{3}{4}$ per cent. Both issues were made at a discount and offered yields of £3 19s. per cent and £3 19s. 6d. per cent respectively. The Government loan of £10 million, which was opened for public subscription in October 1955, showed a return to investors of nearly $4\frac{1}{8}$ per cent after taking account of the terms of the issue. All loans issued by the Government since 1952–53 have ensured, by means of income-tax rebates, that investors would receive a minimum net return of 2 per cent on nominal value after payment of tax, and have offered investors the alternatives of taking up ordinary stock or death duty stock which would be available to meet income tax and social security charges in regard to deceased holders' estates, as well as death duties. These concessions, of course, add to the attractiveness of Government stock, particularly to the large investor.

353. The ruling rate for local body loan issues, which is generally about $\frac{1}{4}$ per cent above Government issues, was $4\frac{1}{4}$ per cent in 1939. In conformity with the stabilisation plan, this rate was reduced in 1942 to $3\frac{1}{4}$ per cent, and continued at that figure until October 1952 when it was raised to 4 per cent. For some time before the above increase was effected, local bodies had experienced considerable difficulty in obtaining loan moneys at $3\frac{1}{4}$ per cent. On 5 October 1955 a further increase in the rate to $4\frac{1}{4}$ per cent was announced following a similar difficulty to that referred to above.

354. The average rate of interest on mortgages registered during the years ending 31 March, which was 5·56 per cent for 1934, declined steadily, and had fallen by approximately 1 per cent by 1939, when it was 4·58 per cent. Thereafter the rate remained fairly steady at $4\frac{1}{4}$ per cent to $4\frac{3}{4}$ per cent until 1946 when a drop to approximately 4 per cent occurred. The rate continued at that figure for a period of six years. This latter fall appears to have been occasioned by the granting of a number of mortgages for rehabilitation purposes at 3 per cent interest. Since 1952 the average rate has shown a tendency to harden, reaching a figure of 4·69 per cent for the year ended 31 March 1955. The

operations of the State Advances Corporation of New Zealand, which is a Government-owned institution, have a considerable influence on the market for mortgage moneys as it is the largest lending institution in this field in the country. The total of the advances on mortgage by the Corporation current at 31 March 1955, and including accrued interest, was nearly £116 million. The interest rate charged, which remained constant at 4⅛ per cent for a number of years, was increased in 1954 to 4⅞ per cent, except for loans for the erection of new houses which remained at 4⅛ per cent. Although the average rate of interest on all mortgages registered during the year ended 31 March 1955 was 4·69 per cent, it is apparent that after making allowance for the extent of the lending on mortgages by the State Advances Corporation and the rates of interest which are charged by that body, the average rate for all other mortgages registered during that year would be about 5 per cent.

355. In 1941, agreement was reached between the Government and the trading banks to reduce the then existing rates of interest for advances on overdraft of a minimum of 4½ per cent and a maximum of 6½ per cent, to 4 per cent and 5 per cent respectively, and the latter have been continued right up to the end of 1955. In view of the increase that has taken place in other interest rates in recent years, bank loans are now the cheapest form of accommodation available to the community, more especially because interest on bank overdrafts is calculated on the daily balances of overdraft accounts, and because very little initial expense is incurred in arranging a bank overdraft. The highest rate of interest which the trading banks can charge for advances on overdraft is 5 per cent, which is about the same as the average rate of interest which other lending institutions are obtaining for advances on first mortgages of real property. The statistics of lending by the banks which appear in another section of this report show very clearly the heavy pressure to which they have been subjected for advances on overdraft.

Deposit Rates

356. Table 53 in Appendix H shows the changes that have occurred in the rates of interest which have been offered for deposits made with various types of institutions. In 1941 and 1942 these rates were reduced in keeping with the policy of cheap money which was instituted largely as a war measure. At that time the economy was subjected to rigid control in order to curb private spending. High interest rates were not needed to encourage savings, partly because the controls on spending made this unnecessary and partly on account of an urge to save prompted by patriotic motives and publicity.

357. It will be noted that rates of interest fixed for deposits in 1941 and 1942 remained unchanged for many years. The first alterations since that time were made in December 1952 when stock and station agents and trading companies were permitted to allow interest at 3¼ per cent on deposits for periods of four years and over. Prior to this change the limit was 3 per cent for deposits for a period in excess of three years. Building and investment societies were also granted, in 1952, an overall increase of about ½ per cent in rates for deposits up to two years. For deposits for a period of more than four years the rate was also increased from 3 per cent to 3¼ per cent. In 1954, these societies were granted a further increase in their long-term rates, from 3¼ per

cent to $3\frac{3}{4}$ per cent for a term of five to seven years, and to 4 per cent for a term in excess of seven years. In 1945 the trustee savings banks received authority to extend the then limit of £200, on which $2\frac{1}{2}$ per cent interest was payable, to £500. The limit was again raised in 1955 with interest at $2\frac{1}{2}$ per cent permitted up to £500, and 2 per cent from £500 to £750. In 1952 the limit in the Post Office Savings Bank was restored to £5,000, which had existed until 1 March 1935. Interest rates were fixed as follows: Up to £500, $2\frac{1}{2}$ per cent; £501 to £2,000, 2 per cent; £2,001 to £5,000, $1\frac{1}{2}$ per cent. At the same time, the maximum amount that could be deposited in a national savings account in any year was raised from £1,000 to £2,000. The alterations in the limits of deposits in both the trustee savings banks and the Post Office Savings Bank did not involve any increase in the maximum rate of interest allowed.

V. CONTROL OF CREDIT

358. We have examined in Part II of Section One of this Appendix the means adopted to control trading-bank credit, and in Part III of Section Two the Government's fiscal policies which determine the extent to which it needs to borrow from the Reserve Bank. Policies which restrain or reduce the volume of money tend to reduce the volume of credit which can be extended by non-banking institutions or persons. Transactions must be settled in money and therefore the current volume of saving and the extent to which existing money can be borrowed, places an upper limit on the amount of lending which is possible.

359. Accordingly, with many forms of credit, a tightening of trading-bank credit will cause businesses which rely on bank credit to reduce the amount they have outstanding with their own customers. However, many of the non-banking sources of credit, and particularly those institutions which extend longer-term credit for investment purposes as distinct from consumption, are not subject, except indirectly, to any influence of bank credit. Their funds come from repayment of former loans, from deposits, or from contractual saving.

360. The controls and shortages during the war and early post-war periods which held down the demand for bank credit operated also to reduce the demand for, and to some extent the supply of, other forms of credit.

361. Certain direct controls over borrowing by various groups have probably also held down the demand for credit to some extent during the period reviewed. The main controls are outlined below.

Control of Local Body Borrowing

362. Borrowing by local authorities has been controlled through the Local Government Loans Board. The Board was set up in 1926, after a period of heavy borrowing by local authorities, some of which had given insufficient attention to their ability to undertake and discharge the liabilities which they had assumed. The Board comprises the Secretary to the Treasury and the Commissioner of Works (both ex officio) and five other persons appointed by the Governor-General. Since 1926 local authorities have been required to obtain the sanction and approval

of the Board to all proposals for raising loans. The Board was empowered to fix the rate of interest on all local body loans, subject to the proviso that the rate as fixed must not exceed the maximum rate determined for the time being by the Minister of Finance.

363. In general, the Board does not appear, until fairly recently, to have reviewed loan proposals in relation to the complete investment programme, public and private, of the country. In 1955, however, it was directed by the Minister of Finance to have regard, in deciding whether or not to grant applications to raise loans, to the essentiality of the projects concerned.

The Capital Issues Committee

364. The control of capital issues dates from 1940, when extensive powers were vested in the Minister of Finance under the Finance Emergency Regulations 1940, the object being to divert as much money and productive power as possible to the war effort. Some relaxation of the controls imposed by these regulations was made in 1946 by exempting from control the formation of new companies with a capital not exceeding £10,000 and issues of capital by any existing company not exceeding in the aggregate £10,000 in any year. Issues of capital include mortgages and debentures.

365. In April 1952, because of heavy pressure on the capital market, the Capital Issues Committee was set up to administer the regulations, and the powers vested in the Minister of Finance were delegated to the Committee. Control by the Committee extends to the following:

(a) The formation of new companies with a nominal capital exceeding £10,000.

(b) Increases of nominal capital of existing companies in excess of £10,000 in any year.

(c) Calls on shares and issues of capital (including mortgages and debentures) where the amount of the proposed call or issue of capital, together with the amount of all other calls or issues made by the company within the preceding year, exceeds £10,000.

(d) The commencement of business in New Zealand by companies incorporated overseas.

366. The maximum rates of interest fixed by the Committee in 1952 for issues of capital were:

Mortgages: $4\frac{1}{4}$ per cent.
Debentures: 5 per cent.
Preference shares: 5 per cent (in some cases with participating rights).

367. Subsequent alterations were made in rates for mortgages only as follows:

August 1952, increased to a maximum of $4\frac{1}{2}$ per cent.
February 1955, increased to a maximum of $4\frac{3}{4}$ per cent.
October 1955, increased to a maximum of 5 per cent for mortgages between £10,000 and £20,000 only.

368. The following is a summary of the decisions of the Committee on applications involving new finance:

(£ million)

Calendar Year	Applied for	Approved	Declined or Deferred
1952 (April to December)	14·9	9·1	5·8
1953	12·0	8·8	3·2
1954	21·4(1)	18·0(1)	3·4
1955 (January to September)	15·9	9·0	6·9

(1) Includes £4·3 million issued by Tasman Pulp and Paper Co. Ltd. but excludes issues by that company to the Government.

Control of Hire-purchase Transactions

369. On 21 July 1955 the Minister of Finance, in his Budget speech, announced the Government's intention of controlling future hire-purchase business in the Dominion.

370. The relevant extract from the speech reads as follows:

A factor which has contributed to the high levels of spending and imports has been the growth in hire-purchase transactions. Hire-purchase regulations have been used successfully in overseas countries to limit spending on consumer goods. After careful consideration the Government has decided to introduce such regulations in New Zealand. These regulations are being gazetted tonight. They provide for minimum deposits and maximum periods for payment of the balance under hire-purchase agreements and credit sale agreements as follows:

—	Minimum Percentage of Cash Price	Maximum Period for Payment of Balance
Motor vehicles	50 per cent	18 months
All other goods	15 per cent	24 months

Subsequently the minimum deposits required for the purchase of trucks were reduced to 33⅓ per cent.

Control of the Level of Interest Rates

371. All of the above controls, in so far as they succeed in reducing the demand for credit, tend to hold down the level of interest rates.

372. When the Government obtains part of its financial requirements by public borrowing it must offer a rate of interest in keeping with market conditions. However, it obtains some funds annually from State Departments and institutions. The Government is able to exercise an influence on the rate of interest which it pays for some of these loan moneys, and the availability of loan moneys from departmental sources reduces its demands on the open market and, on occasions, enables the Government to refrain from entering the open market.

373. In the 1952–53 financial year, for instance, the Government refrained from entering the market because of the large unsatisfied demand for local body and private needs. In that year the Government obtained a substantial part of its requirements, apart from departmental investments, by using certain of its cash reserves, and the balance was borrowed from the Reserve Bank.

374. By maintaining the rate of interest charged by the State Advances Corporation at a relatively low level, the Government can also influence to some extent the general level of interest rates on mortgages.

375. Finally, as indicated above, although there has been some relaxation of controls over interest rates, there is still a wide range of rates which are subject to regulation. The latter are briefly summarised hereunder, together with maximum rates ruling at December 1955:

(a) *Lending Rates*—

(i) Issues of capital by limited liability companies where the amount of the issue in any year exceeds £10,000 such as:

Mortgages: Maximum rates, $4\frac{3}{4}$ per cent (5 per cent for mortgages between £10,000 and £20,000).

Debentures: Maximum rate, 5 per cent.

Prefernce shares: Maximum rate, 5 per cent (in some cases with participating rights).

(ii) Local bodies: Maximum rate, $4\frac{1}{4}$ per cent.

(iii) Bank overdraft rates: Maximum, 5 per cent; minimum, 4 per cent.

(iv) State Advances Corporation of New Zealand—

For advances on first mortgage (other than for erection of new house), $4\frac{7}{8}$ per cent.

For erection of new houses, $4\frac{1}{8}$ per cent.

(Note.—Some of the above interest rates have been increased since 31 December 1955.)

(b) *Deposit Rates*—Maximum rates payable on deposits made with the following institutions are subject to control and will be found in Appendix H:

Post Office Savings Bank.
Trustee savings banks.
Local bodies.
Stock and station agents and trading companies.
Building and investment societies.

The deposit rates paid by the trading banks are to some extent governed by the rates charged on overdrafts, which are subject to control by agreement with the Government.

Appendix D

PART I

Opinion of the Solicitor-General on the Subject of the "Creation of Credit" by the Trading Banks

The legal aspects of money are discussed in Halsbury (3rd Edition), Vol. 7, pp. 303–4, para. 646, in the following terms:

The tokens known as "money", which constitute a legal medium of exchange, consist in England either of coins made and issued by the Crown under the exclusive powers it enjoys at common law, which are now for the most part regulated by statute, or of bank notes made and issued by the Bank of England under statutory powers;

and in a footnote to this passage the following statements appear:

(q) At common law the Crown enjoys the exclusive right of making and issuing money, though formerly this right was frequently granted out as a franchise and could be claimed by prescription; but in all cases the impression or stamping of coins was the King's prerogative, and the grantees of the franchise had usually the stamp sent to them by the Exchequer (1 Bl. Com (14th Edition) 277). The denomination or value at which the coin was to pass current was also determined by the King in all cases, though he could not, it seems, debase or enhance the value below or above the sterling value (ibid., 277, 278; 2 Co. Inst. 577; but as to enhancing or debasing the coinage, see *contra* 1 Hale, P.C. 194). These prerogative rights still exist, but have for the most part been placed upon a statutory basis; . . . Where no statutory provision has been made, the Sovereign, with the advice of the Privy Council, is empowered by proclamation to regulate any matters relating to the coinage and the Mint within the present prerogative of the Crown, and to revoke or alter any proclamation previously made (Coinage Act, 1870 (33 & 34 Vict. c. 10), s. 11 (10), (11)). Every such proclamation comes into force on the date therein mentioned, and takes effect as if enacted by the Coinage Acts, 1870 to 1946 (ibid., s. 11).

This branch of the law is also referred to at some length in 1 Blackstone's *Commentaries* 276–278 and in Chitty's *Prerogatives of the Crown*, pp. 196–199; and in Holdsworth's *History of English Law*, Vol. X, pp. 407–411, the Royal Prerogative in respect of monetary matters is dealt with from an historical point of view.

I think that it is clear from all these authorities that the Royal Prerogative in question relates primarily, if not exclusively, to the regulation of the coinage and that at the most it is confined to the creation and issue of "money proper" or "State money" (Cf. the classification of money and the expressions used in Keynes' *Treatise on Money*, Vol. 1, pp. 5 *et seq*).

The prerogative of the Crown in respect of monetary matters has in my opinion no application whatever to the creation and issue of "credit", i.e., "Bank-money or Acknowledgments-of-Debt", the historical origins of which are to be found not in the common law itself but in the Law Merchant (see Holdsworth's *History of English Law*, Vol. VIII, pp. 113 *et seq*). The correctness of this view is indirectly supported and confirmed by the decision of the Privy Council in *A.G. for Alberta* v. *A.G. for Canada* (1947), A.C. 503, in which the Board in respect of the main issue involved in the case affirmed the unanimous judgment of the Appellate Division of the Supreme Court of Alberta.

In this case the question at issue was the validity of certain legislation passed by the "Social Credit" Government of Alberta. Part I of the Alberta Bill of Rights Act 1946 enumerated and declared certain rights of Alberta citizenship, including the right to the opportunity to engage in gainful employment, or, if that was not available, to a social security pension, and to receive the necessities of life adequate to ensure health and physical well-being, educational and medical benefits, and retirement pensions. In Part II the Act set up machinery for expressing in monetary terms the natural, economic, and human wealth and resources of the Province, and for utilising credit deposits resulting therefrom in payment of the social security pensions and other benefits specified in Part I. Provision was made in Part II for the licensing by a Board of Credit Commissioners of all credit institutions which admittedly included chartered banks, carrying on business within the Province, and for issuing to them Alberta Credit Certificates against which such institutions were to issue to customers, or create in their favour, "credit deposits" over and above the deposits against which a reserve of currency was held; for the transfer of customers' credit deposits; and generally for regulating the creation, expansion, and contraction of, as well as all dealing in, credit where such credit was not based on a reserve of currency of an equivalent value, and for that purpose compulsorily to recruit the services and facilities of existing credit institutions.

It was held by the Privy Council that it is not beyond the business covered by the word "banking" to make loans which involve an expansion of credit, and accordingly Part II of the Act, which aimed at restricting and controlling that practice, was in pith and substance legislation relating to "banking", a subject matter within the exclusive legislative competence of the Parliament of Canada under head 15 of section 91 of the British North America Act 1867, and, accordingly beyond the powers of the Provincial legislature to enact.

The following contentions, *inter alia,* were made to the Board on behalf of the Appellant Government:

. . . Part II does not deal with "banking" within the meaning of that word as used in the British North America Act at the time of confederation, and consequently the control of the issue and creation of credit by the chartered banks over and above their cash reserves is within the legislative competence of the Province . . . While it is conceded that banks deal with credit as part of ordinary banking operations, it is contended that the practice which the banks have assumed of expanding credit over and above their cash reserves did not constitute the practice at the time of confederation, is not banking practice within the meaning of that word in the British North America Act, and is not in conflict with any provision of the Dominion Bank Act, and that consequently there is a field reserved to the Provinces under the general heading of "property and civil rights", and the Province may legislate in this field even though it affects banking operations. That is the broad submission. The Appellant must first bring himself within s. 92 of the Constitution Act, and he must also show that the Act in question does not relate to "banking" and that it does not infringe on any other sub-head of s. 91.

"Credit" extends far beyond the legitimate province of banking; jurisdiction in regard to credit is inseparable from jurisdiction over "property and civil rights," and jurisdiction over credit is neither exclusively nor by necessary implication reserved to the Parliament of Canada in the Act of 1867. The financial credit of the Province is the ability and intention of the people to produce goods and services. (The history of banking was then dealt with to show the relationship which existed between credit and banking, and reference was made to the practice at the time of confederation, and to Breckenridge, *Canadian Banking System,* p. 243, and to Curtis on *Statistical Contributions to Canadian Economic History – Statistics of Banking*). The foregoing establish that at the time of confederation banks had not then assumed the practice of expanding credit as they are doing today . . . It is a function which cannot be recognised as coming within the field of Dominion legislation. Although banking is properly a dealing in credit, it cannot be said that all dealing in credit is banking – that is the crux of the argument . . . The term "banking" as used in s. 91, head (15) of (the British North America Act) should not be given a more extended meaning than that which it had at the passing of the Act . . . It then had a definite and specific meaning, and the Dominion Parliament could not legislate with respect to matters not ordinarily included in the term banking at that time – which did not include expanding credit – and those matters would otherwise be included under the head "property and civil rights" and within the jurisdiction of the provincial legislatures (1947 A.C. at pp. 505–7).

In rejecting these contentions their Lordships in the course of their judgment (at pages 517–8) said:

The concept of banking certainly includes the granting of credit by banks; "a banker", as Duff C. J. said in dealing with the *Alberta Legislation Reference* ((1938) S.C.R. (Can) 100, 116) "has been defined as 'a dealer in credit.'" Whether the expansion of credit now effected by bankers' advances is regarded as wise or unwise, as just or unjust, as economically desirable or economically unjustifiable does not, in the view of their Lordships, affect the point here at issue at all. If it is fairly included within the conception of "banking" it is a matter exclusively reserved for the legislature of Canada.

In the well-known decision of the Privy Council in *Tennant* v. *Union Bank of Canada* (1894 A.C. 31, 46), Lord Watson laid it down that the head "banking" was an expression "wide enough to embrace every transaction coming within the legitimate business of a banker". He further said that, notwithstanding that "Property and civil rights" was a topic allocated to the provincial legislatures under s. 92, "banking" was one of the matters concerning which the exclusive legislative authority of the Parliament of Canada could not be operated without interfering with and modifying civil rights in the Province. This view of the width of the expression "banking" has been recently confirmed by another decision of this Board in *Attorney-General for Canada* v. *Attorney-General for Quebec* (1947 A.C. 33). Undoubtedly the business of banking has developed and expanded greatly since Confederation, though it is by no means clear that even before 1867 banks in Canada were not practising to a more limited extent the kind of operation which it is the object of the Alberta Act now under consideration to prevent or restrict. Harvey C.J. points out that as early as 1859 the legislature of the then Province of Canada was enacting (s. 1. of c. 55 of the Consolidated Statutes of that year): "The business of banking shall, for the purposes of this Act, mean the making and issuing of Bank Notes, the dealing in gold and silver bullion and exchange, discounting of promissory notes, bills and negotiable securities, and such other trade as belongs legitimately to the business of banking." Moreover, s. 85 of that Act provided that "the total liabilities of any Joint Stock Bank shall never exceed three times the amount of its capital" – a provision which sets some limit to bank lending, but not a limit measured by the currency which the bank holds. But in any event, it appears to their Lordships to be impossible to hold that it is beyond the business covered by the word "banking" to make loans which involve an expansion of credit. Legislation which aims at restricting or controlling this practice must be beyond the powers of a provincial legislature.

In New Zealand the trading banks operate under and subject to the provisions of the Banking Act 1908. Section 3 of that Act provides that "all Royal charters and letters patent granted or to be granted by His Majesty to any bank shall to all intents and purposes be as effectual within New Zealand as Acts of the General Assembly thereof". In section 2 "charter" of a bank is defined as meaning "the Act of Parliament, Royal charter, letters patent, deed of settlement, memorandum of association, or other instrument by or under which the bank is incorporated; and includes all amendments of such instrument, and also all articles of association, by-laws, rules, and regulations providing for the administration and management of the bank"; and "bank" is defined as meaning "any person, partnership, corporation, or company *carrying on in New Zealand the business of banking*".

I do not think that there can be any doubt that the "creation of credit" is a legitimate function of a trading bank which has been duly authorised to carry on the business of banking in New Zealand and that in performing this function such a bank is in no way invading or usurping the prerogative of the Crown or infringing any other principle or rule of law.

PART II

Extracts from Authorities Regarding Creation of Bank Deposits, i.e., "Creation of Money"

1. "The Early History of Banking", an article in the *Law Quarterly Review,* January 1918, Vol. 34, page 13:

A promise by a banker of good repute to pay on demand was as good as money and was taken as money. Thus in 1584 Contarini said that a banker could accommodate his friends without payment of money merely by writing a brief entry of credit, and that he could "satisfy his own desires for fine furniture or jewels by merely writing two lines in his books". Thus, to use modern terms, the Italian banks had become not only banks of deposit, but also banks of issue.

2. Macleod, *The Theory of Credit,* 2nd Edition, 1894, page 582:

In former times there were many persons who acted as intermediaries between persons who wanted to lend and those who wanted to borrow. They were called Money Scriveners. The father of John Milton was a Money Scrivener. But no one ever called a Money Scrivener a Banker.

At the present day many firms of Solicitors act as intermediaries between persons who wish to lend and others who want to borrow. They may have some clients who wish to lend, and other clients who want to borrow: and they act as agents between them. The first set of clients may entrust their money to the firm to lend to the second set: and the solicitors receive a commission on the sums which pass through their hands. But no one ever called a firm of solicitors who transact such business "Bankers": which shows that there is an essential distinction between the business of Money Scriveners and such a firm of Solicitors, and the business of "Bankers".

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A "Banker" is therefore a person who trades in the same way that the Public Banks did: they acquired the Property in the money paid in: and in exchange for it they gave Bills of Credit: which circulated in commerce exactly like money: and produced all the effects of Money. And moreover when they bought or discounted, Bills of Exchange, they did it exactly in the same way: they bought them by issuing their own Credit: and Not with Money. And experience showed that they might multiply their Bills of Credit several times exceeding the quantity of money they held: and thus for all practical purposes multiply the quantity of Money in circulation. Thus the essential business of a "Banker" is to create and issue Credit to circulate as Money.

Page 585:

The following is the true definition of a "Banker"

"A Banker is a Trader who buys Money and Credits, Debts, or Rights of action payable at a future time by creating and issuing Credits, Debts, or Rights of action payable on demand."

Page 607:

Having now given an exposition of the actual facts and mechanicism of Banking, it will be as well to contrast the Common Notions respecting it and the Reality.

I. It is commonly supposed that Bankers are dealers in Money only, that they borrow Money from one set of persons and lend it to another set of persons.

The fact is that Bankers are not dealers in Money: they never lend Money. The sole function of Banker is to create and issue Credit: and to buy Money and Debts by creating and issuing other Debts in exchange for them.

II. It is commonly supposed that Bankers act only as agents or intermediaries between persons who want to lend and those who want to borrow. Bankers never act as agents between persons who want to lend and those who want to borrow. Bankers buy money from some persons: and Rights of action from others: exclusively with their own Credit: or by creating and issuing Rights of action against themselves.

3. D. A. Barker, *Cash and Credit,* 1st edition 1910, reprinted 1912 and 1920, page 8:

We must now consider the nature of the business transacted by a typical banking institution situated at a monetary centre such as that described in the last chapter; and for such information we turn naturally to the balance sheets periodically issued by the bank for the benefit of the public. These balance sheets, however, contain on both sides details which are not essential to the limited scope of this chapter and which may, therefore, for our present purpose, be omitted. In its most simplified form the balance sheet may be represented as follows:

Liabilities	£	*Assets*	£
Deposits of customers ..	20,000,000	Cash	4,000,000
		Investments	2,000,000
		Loans to customers ..	14,000,000
	£20,000,000		£20,000,000

To avoid the complications which would arise if we had to consider transactions between many different banks, we will suppose that this represents the consolidated balance sheets of all the banks at our monetary centre; the items shown here being simply the totals of similar items in the individual balance sheets. The total liability of all the banks, then, amounts to £20,000,000, and against this liability they can show £4,000,000 of actual cash, £2,000,000 invested in securities, and £14,000,000 lent to customers.

Firstly, then, as to the item "deposits of customers". To the average non-commercial man a bank is merely an agency for keeping his spare cash and for collecting the money due on cheques payable to him. For him a "deposit" really is a deposit, and the use of such a word naturally leads him to believe that the sum of £20,000,000 entered under this description has actually been deposited in the banks by their customers. But the nature of his mistake is revealed by considering the case of the commercial man who wishes to borrow from a bank. This would-be borrower, we will suppose, is an enterprising man and asks for a good round sum, say, one million sterling; in which request the bank manager good-naturedly acquiesces. Having obtained his loan the borrower has to decide what to do with it. He might, in very unusual circumstances, ask for cash down, but, as a general rule, the bank will give him a credit on its books, and he will draw cheques against that credit as necessity arises. What will be the effect of this transaction on the balance sheet? If he asks for cash the item "cash" will be reduced by one million sterling and the item "loans to customers" will be increased by a similar amount, thus:

Liabilities	£	*Assets*	£
Deposits of customers ..	20,000,000	Cash	3,000,000
		Investments	2,000,000
		Loans to customers ..	15,000,000
	£20,000,000		£20,000,000

But if he merely accepts a credit in the bank's books the change will be as follows:

Liabilities	£	*Assets*	£
Deposits of customers ..	21,000,000	Cash	4,000,000
		Investments	2,000,000
		Loans to customers ..	15,000,000
	£21,000,000		£21,000,000

In this latter case we see that there has been a change on both sides of the account, and that the items "deposits of customers" and "loans" have both been increased to the extent of one million pounds. This is, then, the important point, that a loan by the bank to a customer increases the item "deposits" and that "deposits" therefore are not made up, as they might seem to be, merely of idle balances and savings, but also of credits given by the bank.

4. Henry Clay, *Economics for the General Reader,* 1916, page 190:

If, for example, I deposit five hundred sovereigns with a bank, the bank can immediately lend them to somebody else; if I receive a credit of £500 and give as security my life-insurance policy, the bank can do nothing with that, so long as I satisfy the conditions on which the credit was granted. But whether a bank's client has acquired the right to draw cheques on the bank by depositing wealth with the bank or by receiving an advance from it, he has that right; the bank undertakes to honour cheques signed by him, i.e. to pay cash for them if asked to do so. An account which gives this right to draw cheques, however acquired, is a "Current Account." Banks will also receive money on deposit and pay interest on it, on condition that it is not withdrawn without the giving of some days' notice; an arrangement of this kind is a "Deposit Account."

Suppose a bank has made an advance of this kind; the bank's client will wish to use the advance, and will use it by drawing cheques to the amount of the advance to pay his creditors. Now his creditors in nine cases out of ten will not cash these cheques, but will pay them into their banking account as deposits; thus the advance made by one bank becomes a deposit in another bank, or, it may be, in the same bank. If the creditor to whom the bank's client pays the cheques which he draws against his advance has an account with the same bank, the bank has merely to make two entries in its books, deducting the amount of the cheque from one account and placing it to the other; if the cheques are paid into some other bank, they will be set against cheques drawn on this other bank and paid into the first bank, when the representatives of the two banks meet in the Clearing-House. Thus while deposits or advances are distinct from the point of view of the individual client or bank, from the point of view of the banking system as a whole deposits and advances are largely identical.

We can see now how banks are able to "manufacture credit," we might almost say "manufacture money." At first they accepted deposits of gold and loaned them out again, acting merely as middlemen between those who had and those who wanted cash. Now they accept deposits which they loan out again, and in addition make advances which have no deposits against them, by creating claims on themselves which their clients can transfer in payment for their purchases. The bank makes an advance to a client of £1000; this means that it undertakes to meet the claims for gold on its client to the amount of £1000; it has increased its liabilities by £1000 and this will appear in its balance sheet in the form of an additional £1000 added to its Current and Deposit Accounts, while there is a corresponding increase in its assets appearing in the balance sheet in the form of £1000 added to its Advances to Customers on Security. When a bank makes an advance of £1000 a mutual liability is created between the bank and its client; the bank incurs a liability to find 1000 sovereigns if called on, and the client incurs a liability to repay the bank £1000 when called on. The bank can incur this liability only because it is never called on to meet it in full; the clients to whom it makes advances draw cheques against those advances to pay their debts, but the cheques are never all presented for cash payment; most of them always are paid into other banks as deposits and are cancelled against cheques on these other banks, which are paid into the first bank as deposits.

A bank can safely make advances because those advances will most of them become deposits in other banks, just as its own deposits consist largely of claims on other banks which have made advances to their clients.

5. B. E. Murphy, *Outlines of Economics,* 1924, page 432:

A banker's deposits are of a twofold nature, consisting not merely of cash deposited by the community (Sec. 93 (3) (b)), but also of credits created by the bank and subject to withdrawal by cheque. Suppose, for instance, that a business man discounts a bill with his banker, or otherwise makes arrangement to draw on the bank, either on personal security or by the deposit of collateral, and is granted an overdraft to the extent of £1,000. He thereupon draws a cheque for this amount and pays it to his creditor, who in turn deposits it to his credit at his bank. The net result of the loan is to swell deposits or diminish debits either at the bank which grants . . . the loan, or at some other bank, by the amount of the cheque drawn. Bankers' deposits, therefore, are made up not merely of actual deposits of cash lodged with the banker, which is the popular idea of their nature, but also of loans granted by the same or any other bank, as soon as they are operated on by cheque and the cheque is in turn deposited; the banks thus creating claims on themselves which are readily accepted as currency by the business world.

Once credits are created in a banking system, they can never be extinguished, unless they be permanently withdrawn in legal tender, which remains in circulation or is hoarded or sent abroad, or they are absorbed in liquidation of bank loans, public or private. (Kirkaldy: *British Finance:* 1914–1921, p. 143.)

6. "Committee on Finance and Industry" (U.K.), 1931, (Macmillan Report), page 34:

It is not unnatural to think of the deposits of a bank as being created by the public through the deposit of cash representing either savings or amounts which are not for the time being required to meet expenditure. But the bulk of the deposits arise out of the action of the banks themselves, for by granting loans, allowing money to be drawn on an overdraft, or purchasing securities a bank creates a credit in its books, which is the equivalent of a deposit. A simple illustration, in which it will be convenient to assume that all banking is concentrated in one bank, will make this clear. Let us suppose that a customer has paid into the bank £1,000 in cash and that it is judged from experience that only the equivalent of 10 per cent. of the bank deposit need be held actually in cash to meet the demands of customers; then the £1,000 cash received will obviously support deposits amounting to £10,000. Suppose that the bank then grants a loan of £900; it will open a credit of £900 for its customer, and when the customer draws a cheque for £900 upon the credit so opened that cheque will, on our hypothesis, be paid into the account of another of the bank's customers. The bank now holds both the original deposit of £1,000 and the £900 paid in by the second customer. Deposits have thus increased to £1,900 and the bank holds against its liability to pay out this sum (a) the original £1,000 of cash deposited and (b) the obligation of a customer to repay the loan of £900. The same result follows if the bank, instead of lending £900 to a customer, purchases an investment of that amount. The cheque which it draws upon itself in payment for the investment is paid into the seller's bank account and creates a deposit of that amount in his name. The bank, in this latter case, holds against its total liability for £1,900 (a) the original £1,000 of cash and (b) the investment which it has purchased. The bank can carry on the process of lending, or purchasing investments, until such time as the credits created, or investments purchased, represent nine times the amount of the original deposit of £1,000 in cash.

The process is much the same when we remove the assumption that there is only one bank. The credit granted by one bank may reach the accounts of customers in another bank. There is thus established a claim by the second bank upon the first for cash, and the ability of the second bank to grant loans is improved in so far as that of the first bank is reduced. Over the banking system as a whole therefore, loans and investments made by the banks increase their deposits. There is, however, a limitation on this process. A bank which is actively creating deposits in this way will naturally find that a considerable part of the cheques drawn against them will be in favour of other banks. It will thus lose part of its cash reserve to those banks and must proceed to limit its loan operations if its normal cash ratio is to be maintained. In practice, therefore, no one bank can afford to pursue a policy of creating deposits by making loans or investments which is much out of line with the policies of other banks.

7. "Report of Royal Commission on Monetary and Banking Systems" (Australia), 1937, page 193:

To explain the effects which the making and repayment of bank advances have upon bank deposits, it is convenient to trace what would happen if the whole business of the trading banks were concentrated in a single bank. When an advance is granted, the borrower is authorised to draw cheques upon the bank. Some of the cheques so drawn will be paid in as deposits to the bank by other people. Other cheques will be paid in cash, for example, cheques to pay wages, etc. But much of the cash so obtained will, when spent, be paid in as deposits to the bank, for example, by storekeepers. (In a selected week in 1936, 88 per cent. of the amount paid into trading banks in Australia was in the form of cheques, and 12 per cent. in the form of notes and coin.) In this way the money advanced by the bank will tend to return to the bank in the form of deposits. The increased deposits provide a source from which further advances can be made, and the general tendency of an expansion of advances is to increase the deposits. But the process does not increase the bank's cash reserves, and the limit of expansion is set by the necessity for maintaining adequate cash reserves.

It is obvious that this process of expansion requires customers who deposit, and customers who borrow. The bank cannot lend unless credit-worthy borrowers are forthcoming, nor extend its lendings, unless the loans are returned to the bank as deposits.

In practice the whole of the loans will not invariably return as deposits. There are several reasons why this would not happen. In the first place, the cheques drawn by the borrower may be used to repay, or reduce, an existing advance. In this case, the loan has had no effect upon the total of advances, and has no effect on the deposits. The liability to the bank has merely been transferred from one borrower to another. Secondly, when a cheque is cashed, for wages or other purposes, there is no certainty that all the cash will find its way back into the bank as a deposit. Some of it may be held by the public as money in circulation. In times of prosperity there is a tendency for the public to hold more cash. And thirdly, there is the possibility that the borrower may use his advance to pay for imports, and that the bank has to provide for this out of English money which it holds in London. As this English money is part of the bank's cash reserves the effect of the advance, in this case, is the same as if the bank had paid out cash which will not reappear as a deposit. It follows that it could never be said of any particular advance that it must necessarily affect the deposits. What could be said is that within certain limits the bank, by increasing its advances would, in the course of time, build up its deposits.

8. J. L. Hanson, *Money,* 1953, page 42:

Assuming that Black can find some sort of collateral security acceptable to his bank manager, and that he is agreeable to the bank's terms – the period for which the bank is willing to grant the loan and the rate of interest – Black can now obtain his loan of £500 from the bank. This can be by means of either a loan account or overdraft. If Black obtains a loan account, he borrows a fixed sum – £500 in this case – and interest on the whole of this amount at the agreed rate will commence immediately. If Black obtains an overdraft for £500, it means that he will be allowed to draw cheques up to a maximum of £500 over and above the amount standing to his credit in his current account, but in this case he will pay interest only on the actual amount by which his account is overdrawn.

Whichever method of borrowing he chooses, the result will be the same from the point of view of the quantity of money. In either case (if Black takes full advantage of his overdraft) the bank creates £500 of purchasing power for Black, for when a bank grants a loan to a customer, it is not necessary for it either to hand over to the customer or set aside for his use the sum of £500 in cash, as an ordinary moneylender would have to do. All that the bank has to do is to make a note of the loan or the overdraft to ensure that when Black's cheques are presented they will be honoured.

Of course, if borrowers always required their loans in cash, a bank could only lend cash that had previously been deposited with it. Since most people are like Black and only want to be able to make payments to their creditors by cheque, it becomes possible for banks to create what they lend. Let us suppose that Black, having obtained his overdraft, writes out a cheque for £500 in favour of White as payment for some raw material he has received from him. White will pay this cheque into his banking account, so that the deposit standing in his name will be increased by this amount. Because Black's bank has granted him an overdraft it will honour his cheque when it is presented, although Black has not sufficient funds in his account to meet it. After the cheque has been cleared, Black's account may show that he has nothing standing to his credit, exactly as was the case before he drew the cheque, whereas White's account has increased by £500. Total deposits have, therefore, increased by this amount. Thus loans create deposits. By expanding or contracting their advances to customers, banks can alter the total volume of bank deposits, and since bank deposits can be used as purchasing power, the willingness or otherwise of the banks to grant loans determines how much of this type of money there shall be.

But, it may be argued, will not the repayment of the loan by the customer again reduce the volume of bank deposits to the level at which they stood before the loan was granted: This would be so if only a single loan was involved and if this was repaid at the end of (say) three months. The majority of bank loans are renewed and new loans are constantly being granted as others are being repaid, so that over a long period of time there has been a tendency for bank advances to increase, as the following table shows:

BANK ADVANCES

	£ millions
1935	769
1938	976
1947	1,107
1950	1,603
1951	2,016

When a bank purchases Government Stock (this comprises most of the item "Investments" in the banks' balance-sheets), it pays with a cheque drawn on itself; so that when the people who have sold the stock – the Government itself in the case of a new issue or other investors in the case of existing ones – pay these cheques into their accounts, total bank deposits increase by an equivalent amount. When therefore a bank increases its investments, the effect is similar to that produced when it increases its advances to customers: both increase total bank deposits; that is, the quantity of money. The general policy of the banks is to increase investments when they cannot find a sufficient number of borrowers who are acceptable to them, and to reduce their investments when they wish to increase their advances.

The banks, however, do not possess unlimited power to create money. A banker, if he is to retain the confidence of his depositors, must always be able to pay cash to any of them on demand.

9. Paul A. Samuelson, *Economics – An Introductory Analysis*, 3rd Edition, 1955, page 272:

Can Banks Really Create Money?

We now turn to one of the most interesting aspects of money and credit, the process called "multiple expansion of bank deposits". This is little understood. Most people have heard that in some mysterious manner banks can create money out of thin air, but few really understand how the process works.

Actually, there is nothing magical or incomprehensible about the creation of bank deposits. At every step of the way, any intelligent person can follow what is happening to the banks' accounts. The true explanation of deposit creation is simple. What is hard to grasp are the false explanations that still circulate.

According to these false explanations, the managers of an ordinary bank are able, by some use of their fountain pens, to lend several dollars for each dollar left on deposit with them. No wonder practical bankers see red when such power is attributed to them. They only wish they could do so! As every banker knows, he cannot invest money that he does not have; and money that he invests in buying a security or making a loan soon leaves his bank.

Bankers, therefore, often go to the opposite extreme. They sometimes argue that the banking system cannot (and does not) create money. "After all," they say, "we can invest only what is left with us. We don't create anything. We only put the community's savings to work." Bankers who argue in this way are quite wrong. They have become enmeshed in our old friend, the fallacy of composition: what is true for each is not true for all. The banking system as a whole can do what each small bank cannot do: it can expand investments many times the cash given it.

Our answer then to the basic question is in the affirmative. Yes, the banking system and the public do, between them, create about five dollars of bank deposits for every dollar taken out of circulation and left in the banks.

Page 283:

7. Bank Demand deposits serve as a medium of exchange and a store of value; they are considered, therefore, to be money.

8. If banks kept 100 per cent cash reserves against all deposits, there would be no creation of money when currency was taken out of circulation and deposited in the banking system. There would be only a 1 : 1 exchange of one kind of money for another kind of money.

9. Modern banks do not keep 100 per cent cash reserves against deposits. In 1955 members of the federal reserve system are required to keep, on deposit with the regional Federal Reserve Bank, legal reserves equal to 20, 18 or 12 per cent of demand deposits, depending on city size.

10. Consequently, the banking system as a whole – together with public or private borrowers and the depositing public – does create deposit money almost 5 : 1 for each new dollar taken out of circulation and left on deposit somewhere in the system.

11. Each small bank is limited in its ability to expand its investments. It cannot lend or invest more than it has received from depositors: it can lend only about four-fifths as much. Its deposits are five times its cash, only because its cash decreases and not because its deposits increase. But it does create 1 of bank money for the 1/5 of reserves it retains.

12. The system as a whole can expand at once as each small bank cannot. This can be seen if we examine a monopoly bank in a closed community. The checks written by such a bank always come back to it; therefore the only restriction upon its ability to expand its investments and deposits (its assets and its liabilities in double-entry bookkeeping) is the requirement that it keep one-fifth cash reserve ratios against deposits. When deposits have expanded until they are five times the increase of reserves, the monopoly bank is "loaned up" and can create no further deposits until given more cash reserves.

Appendix E

SOCIAL CREDIT SUBMISSIONS

TABLE OF CONTENTS

I. Introduction

1. The Commission received oral or written submissions from forty-eight persons or organisations who claimed to be supporters of Social Credit or who made suggestions which were closely akin to the principles of Social Credit.

2. The New Zealand Social Credit Association Incorporated was represented at our hearings by counsel who took the opportunity to cross-examine a number of the witnesses appearing before us. The presentation of evidence on behalf of the Association by Miss M. H. M. King and Mr R. G. Young, their cross-examination, and the opening and final addresses of counsel, Mr F. C. Jordan, occupied almost eleven days.

3. The case presented by the Association, which purports to be an educational body, had the approval and full support of the New Zealand Social Credit Political League. We were informed that *"the Social Credit Association and the League collaborated"* in preparing the case, but that it had been felt fitting that the Association should present the case to the Commission, because the Association was not a political body and this procedure would place the League on the same basis as the National and Labour Parties which were not presenting evidence to the Commission. However, Mr Jordan assured the Commission that the case presented embodied the considered views and policy of both the Association and the League, and that these two organisations represented, in his opinion, most of the social crediters in New Zealand.

4. At an early stage of the cross-examination of Miss King by Mr Walsh, representing the Federation of Labour, Mr Jordan objected strongly to questions being put to the witness on the policy of the Political League as submitted to the electors at the last general election. He argued that such questions were irrelevant to the case submitted to the Commission, and explained that the policy put forward by the League at the election had aroused *"the strongest resentment"* amongst some of its members and, as a result, certain matters had been reconsidered and *"rectified"* in the case presented to the Commission. He submitted that witnesses should be examined on the case before the Commission, not on statements made by the Political League in the past.

5. A similar attitude was at first taken by Mr Jordan to examination of his witnesses on material contained in certain Social Credit publications, in particular Mr Wilfrid B. Owen's book *How Social Credit Works* (Mr Owen being the leader of The Social Credit Political League). After some members of the Commission had stressed their difficulty in fully understanding the rather brief written submissions made by the Association and the meaning of many of the terms used in the submissions without referring to other Social Credit publications, and the desirability of clearing up apparent conflicts between the submissions and Social Credit literature, Mr Jordan withdrew his objection. Later, he reiterated it, but finally withdrew it again in respect of literature other than political literature.

6. In the course of discussion, Mr Jordan claimed that the Association's case was not based on Mr Owen's book and that this book had not been approved by the Political League before the election. It had, however, been approved subsequently in April 1955, and was now recommended for anyone wanting to understand the general principles of Social Credit, although it did not represent the considered opinion of the League on all matters dealt with therein. Much later in the proceedings, Mr Young indicated fifteen statements in Mr Owen's book with which he disagreed or which were being reconsidered by the League. (See Note 1 to this Appendix.) Owing to the absence of Mr Owen overseas, Mr Young was acting as leader of the League during the whole period of our public hearings, although he did not appear before us in that capacity.

7. Mr Jordan stressed, in a statement from his principals, that any opinion expressed by counsel or witnesses for the Association on any matter not arising directly out of the submissions of the Association was not admitted to be binding on the Association but must be regarded as the opinion of the person expressing it.

8. In fairness to the Association, the Commission deems it necessary and desirable to draw attention to the foregoing matters so that all interested persons will understand the relationship between the case presented to the Commission and other Social Credit literature which has been circulated throughout the Dominion in the past.

9. It is also desirable at this stage to remove any misconception which may be in the minds of many people that a full Social Credit policy is already being operated in Alberta or British Columbia. It was made quite clear to us by the representatives of the Social Credit Association that, while the legislation of the Government of those provinces was influenced by their Social Credit philosophy, they had been unable, by reason of being only a province of Canada, to implement the financial proposals of Social Credit. According to Mr Young, *"There is nowhere in the world where the financial technique of Social Credit is in operation"*. And Mr Jordan said in his final address, quoting Captain Rushworth, one of New Zealand's earlier Social Credit leaders: *"When we come to apply Social Credit, we will be sailing on an uncharted sea"*.

II. Summary of New Zealand Social Credit Association's Submission

10. We consider that the following is a reasonable summary of the submissions of the New Zealand Social Credit Association Incorporated:

(a) The Association's witnesses contended that the results accruing from the present monetary system were unsatisfactory. They said that public and private debt, taxation, and the cost of living were continually increasing; there was persistent insecurity as to personal livelihood, national prospects, and world trade; and the threat of war was ever present.

(b) They claimed that these defects were the result of the "gap" which was defined as *"the difference between the monetary value based on a fair return to the producers of goods and the providers of services on the one hand, and the amount of purchasing power in the hands of the people desiring to buy at that time, on the other . . . The gap exists today as it has existed in years immediately past . . . The existence of the gap means a shortage in the purchasing power of the community."*

(c) Evidence of this shortage of purchasing power, they said, was to be found in *"experience . . . the evidence of experience is overwhelming"*. There was evidence of the shortage in *"extension of the time-payment system"*; in *"the growth of public and local body debt"* (through which *"depression is kept at bay by the State or local bodies undertaking capital projects financed on debt money"*); in the struggle *"to find export markets"* as a result of *"an internal deficiency of purchasing power"*; and in *"the very occurrence of trade depression"*.

(d) In their view, a chief cause of the "gap" was that the banking system had a monopoly of the creation and destruction of money, so that all money came into existence as a result of interest-bearing loans to producers from the banks. They argued that, since no money was created to pay the interest charges on these loans, the community could meet them only by impoverishing one another or by going more deeply into debt to the banks. They saw a danger that, if these *"sectional institutions"* retained a monopoly of the creation of money, they would in due course *"buy up society, lock stock and barrel"*.

(e) They also claimed that not all the costs of business which must be charged into prices became purchasing power in the hands of the people. Moreover, it was their view that, as the techniques of production improved, the world was faced with the problem of distributing purchasing power to men who were constantly displaced by machines.

(f) As a result, they said, at certain times we had depressions; at others, as in New Zealand since 1936, the community bridged the gap by such means as the extension of the time-payment system and the growth of public and local body debt. They contended that some estimate of the shortage of purchasing power could be gleaned by noting the increase of £411 million in the national debt between 1936 and 1953.

(g) The shortage of purchasing power, they said, was always present in relation to total prices, was cumulative, and appeared to vary in relation to the prices of consumers' goods only in so far as it was masked by increased debt or export surpluses.

(h) The Social Credit Association's witnesses proposed that these alleged deficiencies should be remedied by delivering *"to the people of New Zealand goods and services"* (desired and available), *"including imports in exchange for exports"*, through the provision of *"adequate . . . purchasing power"* without *"public borrowing and oppressive time-payment debts"* and *"without inflation or deflation"*.

(i) This would be done with the help of a *"fact finding and advisory . . . National Credit Authority . . ."* which would make *"a national survey"* to determine:

(i) *"What our nation is capable of producing"*:

(ii) *"What we do produce and the cost of such production"*:

(iii) *"What measures our experts would recommend to increase production of* (desired) *goods and services"*:

(iv) *"The amount of goods and services from time to time available for which there is not sufficient money in the hands of people desiring to buy"*:

(v) *"To whom it is recommended the extra buying power be given and the means by which* (it) *would be given"*.

(j) The National Credit Authority would, accordingly, *"direct the amounts of national credits to be written from time to time to the credit of the nation"*. Such credits would cover:

(i) *"The amount of extra purchasing power to be issued from time to time as a credit to balance production and consumption"*:

(ii) *"Free credits to be written up from time to time to pay for public works of a non-commercial nature, and not to be financed out of taxation."*

Parliament would *"decide on broad lines the allocation of the free credits"*.

(k) If the trading banks and private lenders and institutions failed to provide adequate finance for production, it would be the job of the National Credit Authority to supply the deficiency.

(l) However, the Association's witnesses stressed that it was undesirable to rely solely on producer credit to provide the additional money required from time to time, because creation of money through producer credit at the same time created new debt, on which interest had to be paid and *"on its way to consumers such new money would create as many new costs as it subsequently cancelled"*. Present social security schemes, they said, were also unsatisfactory, because extra benefits were financed from high taxation and this involved the community in a continuous process of inflation. For this reason, they said, social crediters stressed the desirability of issuing consumer credits in the form of debt-free money.

(m) Also, they said, *"Governments representing the people should not borrow; they should be able to lend or give in the name of the people"*. In particular, *"borrowing for public works of a non-commercial nature is an injustice to the nation . . . The nation having made the sacrifice of a temporarily reduced standard of living* (to carry out the public works) *should not be plunged into debt on that account"*.

(n) They claimed that the argument that borrowing for public works was an antidote to inflation was a fallacy, because practically all the money subscribed to public loans would not in any case have been spent on consumer goods. Money created for public works would no more cause inflation, they felt, than money borrowed for public works.

(o) They explained that, though the Association did not wish to be irrevocably committed to any particular method of closing the "gap", the following methods were likely to be satisfactory and should be applied:

(i) Price subsidies in suitable cases to producers who would reduce their selling prices to agreed figures:

(ii) Reduction of taxation:

(iii) The increase of social security benefits without taxation:

(iv) Payment for public works of a non-commercial nature.

The finance in each case would be provided by an issue of debt-free money.

(p) They contended that the issue of debt-free money would contribute to the avoidance of inflation, because:

(i) There would be no debt or interest charges to pass on in prices;

(ii) The subsidy would be payable to retailers only on condition that they reduced their prices; and

(iii) A surer market would give an incentive to greater production.

If necessary, they would also support a switch of production from capital works to consumer goods.

(q) The Association's witnesses regarded farming and the industries allied to farming as the foundation of our national economy. To ensure proper development they felt that those engaged in these industries must be assured of a price in New Zealand money sufficient to meet costs plus a reasonable profit.

(r) They advocated that reserves of foreign exchange should not be built up beyond a reasonably prudent level.

(s) Finally, they argued that we should not sacrifice control of our economic life *"by joining Bretton Woods or any similar agreement"*.

III. Consideration of the Social Credit Analysis of the Existing System

11. The foregoing briefly summarises the submissions made by the Social Credit Association, and it is primarily on those submissions that this Appendix is based. The Commission also heard a number of other witnesses who classed themselves as Social Credit supporters. There were, however, many serious inconsistencies between the different versions of Social Credit and even between the submissions and the evidence of the representatives of the Social Credit Association. In the course of the following discussion of the Association's case, we shall attempt to indicate not only the apparent conflicts between the Association's submissions and evidence, but also some of the major differences between the views of the Association and of other witnesses on certain matters.

A. THE NEED FOR PERSPECTIVE IN CRITICISING THE PRESENT SYSTEM

12. It should be evident from our report that we do not feel that the present monetary system is perfect. Criticism of it is legitimate; but the Social Credit Association's criticism, which was similar to that of most other Socal Credit witnesses, is distorted. Many factors necessary to a balanced judgment are not taken into account.

Debt

13. For example, although it is true, as Miss King asserted, that New Zealand's national debt, in total and per head of population, is now much larger than it was in 1933, that is not the full story. Changes in the volume of production and in prices, which are reflected in changes in the gross national income, must be considered.

14. In 1932–33 the national debt was more than double that year's gross national income; but in 1954–55 it was only about four-fifths of that year's gross national income. Similarly, in 1932–33, interest on loans used up £59 in every £100 collected in taxation; in 1954–55 interest used up only £9 in every £100 of taxation.

15. Again, the vital difference between interest paid on loans held within New Zealand and interest paid on loans held outside New Zealand must be taken into account. Interest paid in New Zealand is merely a transfer of money from one pocket to another within the country, whereas interest paid outside New Zealand uses foreign exchange which could otherwise be used to buy imports. In March 1933 the Government's overseas debt was £174 million; in March 1955 it was only £100 million.

In 1932–33 overseas interest payments used up £18 in every £100 of overseas earnings; in 1954–55 interest payments used only £1 2s. in every £100.

16. These comparisons, which take into account changes in population and production, and the rise in prices, wages, and other incomes which has occurred during the period, and thereby relate debt to ability to pay, establish that the debt of the country today is relatively a very much lighter burden than it was twenty-two years ago.

17. The comparisons, it is true, are made between periods of economic adversity and prosperity, but this was the basis chosen by the Social Credit Association's witnesses in the presentation of their case.

18. It is a mistake to think that all the interest payments on the public debt go to a few wealthy people or firms. For instance, of the internal public debt of £631 million as at 31 March 1955, £182 million was held by the Post Office as the result of the investment of small savings by the public; £79 million represented reserve funds held for the benefit of the primary industries; £60 million was held by the Reserve Bank; and £23 million by the Government Superannuation Board and the Government Life Insurance Office. When other departmental investments are added to these, we find that £410 million of the internal public debt was held by Government or semi-governmental agencies. Of the debt held by the public, by far the greater proportion was held by insurance companies and trustee savings banks (which have always used Government securities as a major channel for investment of their customers' premiums or deposits) and by public companies. The trading banks (which according to many Social Credit witnesses held the State in bondage) held only £11 million of the public debt. And, of course, the largest bank is State owned. The money for payment of the annual interest charges is collected from the public in taxation; but it is clear from the above that a very large number of the public receive a share of the interest payments in the form of interest on small savings, bonus payments on life insurance, and so on.

19. Finally, we must not forget that the cost of many public assets has been met from the savings which the Government has been able to borrow from people in New Zealand and overseas. Some of the enterprises in which borrowed money is invested are earning for the State interest and profits, which amounted to £11·4 million in 1954–55, and which could reasonably be offset against the Government's interest payments of £20 million. Other assets, such as roads, bridges, and schools, do not directly earn income, but they certainly contribute to national production. Even the £188 million which was used for war purposes cannot be regarded as completely unproductive, in that it was of assistance in winning a struggle to retain our freedom to develop the type of society we want.

20. However, the most important point is that the great bulk of the increase in public and private debt in recent years represents a transfer of purchasing power from one section of the community to another. The increased prosperity of the country has led to a considerable increase in money savings. In addition it has led to a much greater desire by producers to borrow to expand their output, to much greater willingness of people generally to borrow in order to buy, build, or furnish a house or to purchase other goods they want, and to increased need for the central

and local governments to borrow to provide the extra public facilities, such as roads and streets, water supply, sewerage, power reticulation, etc., which an expanding economy requires.

21. For these reasons, private individuals, business men, farmers, companies, and public authorities have felt able and been willing to increase their total money indebtedness; but at the same time those who have lent to them directly or through a financial institution have increased correspondingly their interest-earning assets. In short, if internal public and private debt has increased, so has public and private money wealth; for what is owed by some members of the community is owned by others.

Taxation

22. A similar distortion marks the Social Credit Association's reference to taxation. Again, some factors necessary to a balanced judgment are not taken into account.

23. It is true, as the Association pointed out, that taxation per head of population increased from £53 12s. 4d. in 1942–43 to £99 8s. 3d. in 1952–53, but the proportion of the national income taken in taxation and the use made of the proceeds cannot be disregarded.

24. Unfortunately, the necessary figures are not available for the years chosen by the Social Credit Association, but the trend can plainly be seen by comparing the figures for 1938–39 and 1954–55.

25. The fact that the Government took a greater amount per head of population in taxation in 1954–55 than in 1938–39, and also a greater part of the gross national income (defined in the table on page 353) must be measured against the use made of the tax money.

26. The Government uses such funds for three broad purposes: to meet the running expenses of the country; to redistribute the national income through subsidies, social security payments, and so on; and to pay for capital works.

27. The table shows that in 1954–55 the Government, by comparison with 1938–39, used a smaller part of the national income on capital works and about the same part on running expenses, but it used a larger part for redistribution of the national income. Also, in proportion to the gross national income, it was left, as it was in the four previous years, with a surplus of current revenue over current expenditure considerably greater than the surplus in 1938–39. This surplus is used for capital works, or to pay off Government indebtedness, or to build up a fund against future needs. Broadly, we can say that the Government has used a much greater proportion of taxation for capital purposes than it did before the war, when its capital projects were financed almost entirely by borrowing.

28. The Government's spending on capital works and administrative, defence, and social services involves the use of labour, materials, and equipment. Redistribution through subsidies, interest on internal debt, and social security benefits merely involves a transfer of money from one section of the community to another; there is no real burden on the community as a whole apart from the comparatively small cost of administering the transfers.

29. The vital fact shown by the table below is that the Government is using no greater share of the nation's real resources, by spending on capital works and other goods and services, than it did sixteen years ago. It is, indeed, using a slightly smaller share and, as the witnesses for the Social Credit Association so often pointed out, it is real resources, not monetary values, that matter.

Central Government Taxation and Expenditure in New Zealand as a Percentage of Gross National Income

	1938–39 Per Cent	1954–55 Per Cent
1. Total taxation collected	16·4	25·3
2. Current expenditure on goods and services	10·0	9·9
3. Transfers (social security monetary benefits, subsidies, transfers to local authorities and interest on debt paid in New Zealand)	8·0	11·7
4. Surplus of current revenue over current expenditure on goods and services and transfers	0·6	5·8
5. Capital works expenditure	7·0	6·3

NOTE: Gross national income at market prices = the value of the goods and services produced in New Zealand during the year before deduction is made for depreciation of our capital assets.

—Compiled from Official Estimates of National Income and Expenditure 1955.

Cost of Living

30. The Social Credit Association's use of the rising cost of living as proof of the defects in the existing system must also be brought into proper perspective. Most people depend mainly upon salaries and wages for their incomes and it is therefore pertinent to examine the changes which have taken place in their economic position. The statistics show that the overall rise in the nominal weekly wage rate for adult male workers during the past twelve years has more than offset the fall in the purchasing power of the pound. Increases in nominal wages measured against increases in prices leave those wage earners who today are on the prescribed minimum rates one-fifth better off on the average by comparison with 1942 (see table given on page 354). It appears equitable that their position should have improved in view of the intervening increases in productivity.

31. But the shortage of labour and the consequent competition amongst employers have brought the rates of wages to a level probably about 10 per cent on the average in excess of minimum rates. To that extent the position of the average wage earner has been still further enhanced in relation to prices.

32. Of course, some sections of the community have improved their economic position even more than the wage earners, and on the other hand, now as always, there are some people whose incomes are insufficient to provide them with a desirable standard of living. In particular, those on fixed incomes have suffered a material disadvantage through loss of purchasing power. But the fact remains that the real income of the community as a whole has increased appreciably during the past twelve years. The goods available for use in New Zealand per head of population were 23 per cent greater in the year ended June 1954 than they were in 1939. This indicates that on the average the people of New Zealand are enjoying a considerably higher standard of living.

Index Numbers of Prices and Wages in New Zealand
(Base: 1926–30 = 1000)

	Retail Prices (All Groups)	Nominal Weekly Wage Rates (Adult Males)	Effective Wage Rates (Adult Males)
1942	1109	1222	1102
1954	1847	2459	1331

(Effective, or "real", wages are arrived at by dividing the index numbers of nominal wage rates by the corresponding all-groups index numbers of retail prices, and multiplying by the base value of 1000.)

Insecurity

33. As to the personal insecurity which the Social Credit Association considers to be a feature of contemporary New Zealand life, this is plainly absurd. New Zealanders, in general, have greater security than in the past. The State now provides reasonable protection against loss of income through unemployment and prolonged illness and against real hardship in old age; that is, protection against the vicissitudes of life which are the basic causes of personal insecurity. A further fact is that since 1946 there have never been more than 100 registered unemployed and never less than 11,000 registered vacancies. So far as the post-war years are concerned, these figures indicate a greater degree of security for the average employee than ever before in the country's history.

34. The Social Credit Association's proposition that there is insecurity in national prospects and international trade must be measured against Mr Colin Clark's computation in his submissions that *"the total market for internationally traded goods rose from £51 billion (adjusted to the present day purchasing power of money) in 1938, to £60 billion in 1950, and £74 billion in 1954"*. While some trading uncertainties must always exist, the buoyant receipts of recent years have enabled substantial reserve funds to be built up for the primary industries within New Zealand. The guaranteed price arrangements for dairy produce, and the floor price schemes for meat and wool, are designed to ensure a measure of stability (and therefore security) much greater than in the past for those engaged in these vital industries.

35. Finally, we have not heard a shred of evidence which would support the view that the *"ever-present menace"* of war can be attributed to some flaw in the monetary system.

Conclusion

36. To sum up, we find serious deficiencies in the Social Credit Association's analysis of the results accruing from the existing monetary system. Many of the contentions are completely unsupported by evidence; in the case of debt and taxation those statistics are selected which show the position in the worst possible light; little attention is paid to external factors which have played a major part in the rise of the cost of living in New Zealand since the war. The marked improvement which has taken place in the standard of living and the volume of goods and services available for use in New Zealand, both in total and per head of a much greater population, is ignored.

37. However, lack of balance in assessing the results accruing from the existing system does not of itself invalidate the Social Credit Association's diagnosis of the operation of the system and to that we must now turn.

B. THE IMPORTANCE OF THE "GAP"

38. The Social Credit proposal for an issue of debt-free money depends on proof of a gap between purchasing power and prices. The transcript of the proceedings furnishes abundant evidence in support of this statement. For example, in Miss King's examination the following passage occurs:

Question: I don't want to make any extensive use of Mr Owen's work (*How Social Credit Works*) but would you agree with this statement: "There is no single cause operating in the world today which is of such primary importance as the disparity between purchasing power and prices. The total argument for Social Credit as an effective reform rests on the proof of this disparity. If it fails, the case for Social Credit fails . . ."

Miss King: I would say that the case for the application of Social Credit, the use of it, would fail.

And in Mr Young's examination this passage appears:

Question: Suppose you had your survey, and it proved, in fact and statistically, that there was no gap, there would be no room for the application of any of these (Social Credit) measures, would there?

Mr Young: No, that is true . . . but we feel very confident that that would not be the result.

Question: . . . but, assuming there proved to be no gap, that would end the whole of your case, wouldn't it?

Mr Young: That is so.

Question: No gap, no Social Credit?

Mr Young: That is so.

And Mr Jordan declared:

There is no necessity for the creation of any money to balance available goods and services with purchasing power in the hands of the community if the gap does not exist.

C. WHAT IS THE "GAP"?

39. The Commission had great difficulty in ascertaining exactly what was meant by the term "the gap". In his submissions, Mr Young defined "the gap" as *"the difference between the monetary value based on a fair return to the producers of goods and the providers of services on the one hand, and the amount of purchasing power in the hands of people desiring to buy at that time, on the other"* . . . *"'The Gap' exists to-day"*, he said *"as it has existed in the years immediately past"*.

40. But Miss King distinguished two different "gaps" or, as she preferred to put it *"two degrees of the gap"*:

(a) There was never enough money in the hands of individuals as personal income to buy the whole of production; and

(b) Only under certain circumstances was income sufficient to buy the end or final production at prices remunerative to producers.

Miss King admitted, under examination, that there was no need for individuals to be able to buy the whole of production, i.e., to pay for all the capital and intermediate goods produced during the year as well as the consumer goods and services appearing on the retail market. The witness failed completely to show us the significance of the first degree of the gap.

41. Mr Young and Mr Jordan continued to speak as though there were only one gap – Miss King's second degree of the gap – to be filled. The concept is still not clear, e.g., the witnesses did not explain whether *"purchasing power"* means the amount of money in the hands of consumers at a given time, or the flow of income which they can expect over a future period; whether it includes or excludes their accumulated savings; whether it includes or excludes income earned in the production of capital goods; whether production refers to actual or potential production; and how we are to determine what people will be *"desiring to buy"* at a given time. Nevertheless it is our duty to examine the evidence put forward by various Social Credit witnesses to prove that there must be a chronic gap.

D. EVIDENCE PUT FORWARD TO SUPPORT THE THEORY OF A CHRONIC GAP

(a) Evidence from Experience

Growth of Debt

42. Miss King in her submissions claimed that the growth of public and local body debt between 1933 and 1953 *"measures the extent to which depression is kept at bay by the State or local bodies undertaking capital projects financed on debt money"*. Likewise, Mr Young, in his submissions, told us that *"some estimate of the shortage of purchasing power can be gleaned by noting the increase in the national debt during the years March 1936 to March 1953"*. The extension of the time-payment system was also cited as evidence of a gap. The Association's attitude here was shared by most other Social Credit witnesses.

43. Under examination, it was conceded by Miss King that the statistics showed no increase in the total indebtedness of local bodies between 1933 and 1953. The table on page 357 supplied by the Government Statistician showing some of the holdings of the internal debt of the Central Government indicates that the great bulk of the increase of £472 million which had taken place from 1933 to 1953 could be attributed to the investment of savings by the public, either directly or indirectly, through the Post Office and trustee savings banks, national savings, the reserve funds held for the benefit of the primary industries, and various public accounts.

HOLDINGS OF PUBLIC DEBT

The attached statement shows the increase between 1933 and 1953 in holdings of public debt by the Post Office Savings Bank, the Public Account, and some other large holders of public debt. The amount of £60,045,000 held by the Reserve Bank on 31 March 1953 includes £20,000,000 in respect of the 1948 exchange adjustment.

Government Securities Forming Part of the Public Debt Held by the Post Office Savings Bank, National Savings, Industry Accounts, and the Banking System, 1933–53

	1933 £(000)	1953 £(000)	Increase £(000)
Post Office Savings Bank and national savings	41,437	127,478	86,041
Dairy Industry Account	..	21,460	
Meat Industry Account	..	38,499	
Wool Commission	..	23,980	
			83,939
Public Account	2,767	54,374	51,607
Reserve Bank	..	60,045	60,045
Trading banks	5,800	11,700	5,900
Trustee savings banks: Government stock ..	2,453	24,418	21,965
National savings stock	..	7,588	7,588
National savings bonds	..	88	88
	52,457	369,630	317,173

44. The bulk of the remainder of the increase in the debt resulted from investments by insurance companies (placing the premiums paid by policy holders), by public companies, and by the Government Superannuation Board. That is to say, during the period in question, a section of the community found it unnecessary or undesirable to spend part of its income and transferred that part temporarily to the Government in return for an agreed annual interest payment. We cannot agree that this provides any evidence of a community shortage of purchasing power.

45. No evidence was produced to support the contention that the growth of hire-purchase indebtedness proved that there was a general shortage of purchasing power. No matter how high the level of the national income is, there will always be some people who want to have goods like a motor car or refrigerator now and pay later, rather than to save now and buy later. The fact that they buy on hire purchase does not prove that purchasing power is generally inadequate. As is the case with the increase in public debt, the increase in hire-purchase indebtedness represents, in the main, a transfer of purchasing power from one section of the community with surplus income to another which wishes to spend in excess of its income.

46. Towards the end of his cross-examination, Mr Young agreed that the total amount of money in the hands of the public could have been increased as a result of the growth of public and private indebtedness only to the extent that additional bank credit had been used to finance it. As far as the public debt is concerned, of the above increase of £317 million between 1933 and 1953 only £60 million was taken up by the Reserve Bank and £6 million by the trading banks. £20 million of the increased holdings of the Reserve Bank, representing compensation granted to the bank by the Government on account of the exchange adjustment of 1948, did not add to the volume of money in New Zealand. The total of the advances and investments of the Reserve Bank and the trading banks for all purposes increased by about £220 million between 1935 and 1955, i.e., by an average rate of £11 million per annum. This amount is very considerably less than the annual gap which most Social Credit witnesses seemed to have in mind. Over the same period, the Retail Prices Index (first quarter 1949 = 1000) rose from 632 to 1434. This would indicate that the supplementation of purchasing power which occurred through

bank credit during this period was more than adequate to counteract any tendency towards a shortage of purchasing power which might have developed in its absence due to the growth of production and population or rises in overseas prices.

47. The Association seemed to have second thoughts on this issue, for Mr Jordan, in a document addressed to the Commission dated 5 October 1955, commenting on a statement of the Reserve Bank, said, *"Our submissions do say that the increase of debt is evidence of a "Gap", but increases in debts, public and private, are neither a measure of the "Gap" nor conclusive proof of it".*

The Struggle for Export Markets

48. The Social Credit Association claimed that an internal deficiency of purchasing power made it necessary to find export markets and achieve a favourable balance of trade. We agree that it is necessary for New Zealand to keep and enlarge her export markets for primary produce if the present standard of living is to be maintained or improved. But surely this need does not arise from any internal deficiency of purchasing power; it would be quite ridiculous to expect the local market to absorb all our production of wool, meat, and dairy produce. The need to keep and enlarge the export markets arises from the necessity to import materials and equipment for our growing manufacturing and service industries and to import other goods which cannot economically be made in New Zealand. It is also true that, overall, New Zealand has had a considerable surplus of receipts over payments in her external transactions since 1939. This has arisen not from any necessity to sustain internal purchasing power, but from the necessity to build up foreign exchange reserves from the dangerously low level which they had reached before the war and to maintain them at an adequate level in relation to the much higher world prices now ruling. In this connection Mr Young said that he would prefer to see our reserves a little higher than they were in the middle of 1955, although they would be adequate, he thought, if they were conserved.

The Occurrence of Trade Depressions

49. Miss King regarded the occurrence of trade depressions as evidence of a persistent shortage of purchasing power. Of course, we have had no depression since the early thirties. Asked whether she would regard a boom as evidence of a surplus of purchasing power, she replied that a boom was a condition of a surplus or an equality of purchasing power in relation to consumer goods, but not in relation to total production. As indicated earlier, she was unable to make clear to us the significance of this "Gap Major" to which she repeatedly referred.

Other Factors

50. Certain other factors were cited by the Association's witnesses and by the other social crediters as evidence of a gap. Mr Young mentioned the case of a firm in Otorohanga which had suffered a marked fall in turnover and said he felt its predicament was typical of many firms in the country at that time; but the statistics of retail trade did not support his contention for the country as a whole. Mr Dodds claimed that the

fact that it was necessary to employ salesmen and adopt various devices to stimulate sales was evidence of a shortage of purchasing power; but it is surely necessary in any economy to bring to the attention of consumers the products which are available for sale and the terms on which they may be bought, especially in a system of competition for custom among private firms, a system which Mr Dodds and most of the other social crediters claimed to support. Finally, several witnesses drew attention to the relatively poor circumstances in which certain old-age pensioners were living in New Zealand as evidence of the existence of a gap; this may be evidence of a maldistribution of income, but it does not prove that the general level of money income is too low.

Conclusion

51. To sum up, the "evidence from experience" adduced in support of the contention that there is a chronic gap is completely unconvincing and unsubstantiated by any relevant statistics.

(b) Theoretical Argument as to the Existence of a Gap

The A plus B Theorem

52. Surprisingly, only oblique reference was made in the Association's submissions to the A plus B theorem of Major Douglas, which has, in the past, been the main theoretical device used to justify the contention that there is a chronic gap. Miss King said, *"A careful consideration of the facts regarding the way in which production is financed, the creation and transfer of costs, the liquidation of costs . . . the way in which prices are built up will soon lead to a conclusion . . . that there is a chronic shortage of purchasing power in the hands of the people relative to the price of total production . . . It is easy to deny this by denying the facts, by declaring that A plus B is not greater than A, or that A is the same thing as B when it has just been defined as something different, but denial does not alter the facts"*.

53. Apart from this, the A plus B theorem was not mentioned. Mr Jordan made it clear that the omission was deliberate. In discussing the relationship between the case submitted to the Commission and Mr Owen's book *How Social Credit Works,* he said, " *. . . the case makes some things very clear which I think were not made clear in the book. For example it makes it quite clear . . . that we would issue money as against an approved statement showing that there are goods available against which that money can be issued . . . You will find that that book discusses the A plus B theorem at length, something which is not actually mentioned in the case"*. After the reference in Miss King's submission had been drawn to his attention, he was asked whether the Association was abandoning the theorem.

54. He replied, *"We are not abandoning it, but we are saying . . . it is of academic interest, because we tried to make it clear in the case that as far as the A plus B theorem is concerned, to use Major Douglas's own terms, it should be decided on the facts, not on the theory"*. Under examination, Mr Young said that the Association did not regard the A plus B theorem as a basic principle. *"It is not worth arguing about"*, he said. *"Let us have the facts and prove conclusively whether it is right or*

wrong." From the foregoing, it would appear that this theorem, which in the past has been treated almost as the foundation of Social Credit, is now virtually discarded by the New Zealand Social Credit Association.

55. However, since Mr Adams (an advocate of Social Credit) regarded the theorem as *"the basis of the gap and . . . fundamental"* to the Social Credit case, and since it was used by one or two of those presenting written submissions, it is necessary to discuss it briefly in this report. First of all, we must state the theorem.

56. Major Douglas made a close examination of more than one hundred large businesses in the United Kingdom and found that, in every case, the total costs incurred were greater than the sums paid out in wages, salaries, and dividends. On the basis of his study he stated the following proposition; according to Mr W. B. Owen in *How Social Credit Works,* pages 48–49:

> A factory or other productive organisation has, besides its economic function as a producer of goods, a financial aspect. It may be regarded on the one hand as a device for the distribution of purchasing power through the media of wages, salaries, and dividends; and on the other hand as a manufactory of prices – financial values. From this stand-point its payments may be divided into two groups:
>
> GROUP A: All payments made to individuals (wages, salaries, and dividends).
>
> GROUP B: All payments made to other organisations (raw materials, bank charges, and other external costs).
>
> Now the rate of flow of purchasing power to individuals is represented by A, but since all payments go into prices, the rate of flow of prices cannot be less than A plus B. Since A will not purchase A plus B, a proportion of the product at least equivalent to B must be distributed by a form of purchasing power which is not comprised in the description grouped under A.

A simple diagram will help to illustrate this:

"A" PAYMENTS
Wages and salaries .. .. .. £90 } £100
Dividends .. .. .. £10 }

TOTAL COSTS — TOTAL PRICES £150 — Purchasing power £100 cannot buy goods priced at £150.

"B" PAYMENTS
Raw materials .. .. .. £30 } £50
Bank charges, etc. .. .. .. £20 }

57. Let us look briefly at the payments, other than salaries, wages, and dividends made by any business firm, i.e., Major Douglas's B payments, which he implies do not result in any distribution of purchasing power. These payments can be classified into five main categories:

(a) Payments for goods and services from other individuals or firms.
(b) Payment of rent.
(c) Payment of interest or bank charges.
(d) Depreciation allowances.
(e) Undistributed profits.

58. Mr Young conceded under examination that many of the purchases of goods and services which firms made would result in payments to individuals, e.g., purchases of raw materials from farmers, purchases

of standing trees by a sawmilling company, and so on. So would the payment of rent and interest in many cases. In short, many of the items classed as B payments by Major Douglas do represent a flow of purchasing power to individuals.

59. Other payments for goods and services and other rent and interest payments may be made to business organisations. But this does not mean that the sums paid are lost as purchasing power if they are paid to organizations within New Zealand. The B payments made by the retailer to the wholesaler are used by the wholesaler to make A payments of salaries, wages, and dividends and B payments to other individuals and firms. The B payments made by the wholesaler to the manufacturer in turn become the A and B payments of the manufacturer. As the B payments are traced back to the end of the process of production, it will be found that they all ultimately become A payments. That is, the sums paid by the buyers of finished goods or services become the A and B payments of the firms which supply them and their B payments eventually become the A payments of firms at an earlier stage of the process of production and sale. Thus, all the money paid in prices by buyers of finished goods and services ultimately becomes income in the hands of the workers or the owners of the resources which have been used in their production.

60. The issue is complicated to some extent in New Zealand by the fact that some payments are made to people and firms overseas and some receipts come from overseas. As long as external receipts and payments are in balance, the preceding argument is not affected. However, if receipts from overseas exceed payments overseas, a portion of the incomes received by exporters during the year has not been matched by bringing goods and services of equivalent value into the country. Therefore, incomes in New Zealand will be greater than the value of the finished goods and services retained in the country and the goods imported during the year. Conversely, if overseas payments exceed receipts from overseas incomes will be less than the value of finished goods and services retained in the country and imported during the period concerned. Of course, it is impossible for overseas payments to exceed receipts for any great length of time. There is therefore nothing inherent in the system to produce a permanent shortage of purchasing power.

The Time Factor in Production

61. As indicated above, Mr Young recognised some of the flaws in the A plus B theorem. But, in the course of discussion, he complained that a lot of the criticism of the A plus B theorem neglected the time factor in production.

62. To illustrate what is meant by this we cannot do better than quote "H.M.M." as does Mr Owen on page 55 of *How Social Credit Works*:

> "All B items in cost were once A items – that is, they were somebody's income if we go back far enough. But money earned in the past is spent in the past and no longer exists. (It was created in production and cancelled in consumption.) Therefore, while current incomes avail to meet the current A items in prices, past incomes are not available to meet current B items.

63. The following example given in Mr Owen's book, page 54, was discussed with Mr Young:

Diagram of a Series Production

Year	Business	Bank Loan	Costs			Sales Prices	Payments		Profit
			Raw Material	Over-head	Wages		Bank	Interest	
		£	£	£	£	£	£	£	£
1951	Farmer	350	200	50	100	..	..	..	..
1952	Farmer	..	..	..	..	500	350	20	130
1952	Miller	1,000	500	200	300	..	..	..	..
1953	Miller	..	..	..	..	1,500	1,000	60	440
1953	Baker	2,500	1,500	400	600	..	..	..	..
1954	Baker	..	..	..	..	3,000	2,500	150	350
Totals	..	3,850	2,200	650	1,000	5,000	3,850	230	920

In examining this example of series production we see how overdrafts from the banks are repaid and such costs liquidated. The prices of the goods produced through the series were: wheat, £500; flour, £1,500; bread, £3,000; a total of £5,000. The money disbursed in the series was: raw materials, £2,200; overheads, £650; interest, £230; wages, £1,000; profits, £920. A total also of £5,000. If all these disbursements were saved and all made available at one particular moment of time the bread could have been all sold.

But they were not all saved and they were not all available. A period of three years has elapsed since the first disbursements were made and most of these were spent and no longer exist. This is true right through the series. The mill cannot grind with the water that has passed.

We note also that all costs incurred in one stage are allocated to the next stage and appear in prices even though the money representing these costs has been spent, so that when we come to the ultimate product – bread – all that is left to liquidate the total price of £3,000 is wages £600 (and part of this may be spent), profit £350, and proportion of bank interest, say, £50 – a total of £1,000.

64. Under examination, Mr Young agreed that this example failed to take account of the continuity of production and of the continuity of payments out in the course of production. He recognised, for example, that the farmer and the miller would still be operating in 1954 and making payments to individuals somewhat similar to those which they made in previous years. But the table takes no account of this fact when it shows a deficiency of purchasing power of £2,000 in that year.

65. Mr Young said that he placed no particular reliance on an example of this kind to prove that there was a gap. He wanted a proper national survey.

Interest, Depreciation, Undistributed Profits, and Other Savings

66. It can be seen that the Association's witnesses placed very little faith in the A plus B theorem as theoretical evidence of the existence of a gap. However, in common with several other witnesses, they selected certain B payments as explanations of the alleged shortage of purchasing power.

67. Great emphasis was placed on an alleged monopoly of the creation and destruction of money by the trading-bank system and the consequent necessity for interest to be paid on all the money which was created. Several witnesses mentioned depreciation charges and other business reserves as costs which no one received as a wage, salary, or dividend. Some selected repayments of past debts, especially of bank advances, as a cause of shortage. And, finally, most seemed to feel that the fact that

people saved part of their income meant that producers could not recover their full costs of production. Even if the savings were reinvested, they claimed that the problem remained because then two sets of costs were created against one set of incomes.

68. We discuss most of these arguments quite fully in the section of our main report dealing with Social Credit. Briefly, we find:

(a) **That the trading banks do not have a monopoly of the creation and destruction of money.**

(b) **That all money does not come into existence as an interest-bearing debt to the trading banks.** (A large proportion has been put into circulation because the Reserve Bank and trading banks have bought more foreign exchange than they have sold, or because the Reserve Bank has made advances to the Government or to marketing organisations.)

(c) **That it is fallacious to argue that payments of interest to the banks, creation of reserves by business firms, and savings by the people must cause a gap.** (The Social Credit witnesses here assume either:

(i) That the banks' interest receipts, business reserves, and savings are hoarded – whereas in fact, in normal circumstances, all these items will either be spent directly or made available for borrowing by other spenders – or

(ii) That each unit of money is cancelled as soon as it is spent and that fresh supplies of money are required to finance each new transaction – but in fact, money circulates; each unit of money helps to finance several transactions and becomes part of the incomes of several people during the year.)

69. The repayment of loans is broadly comparable with savings. We cannot see that any purchasing power is destroyed when one individual or firm repays a loan to another. The person who receives repayment is able to spend or relend the money. Purchasing power could be destroyed when a bank loan is repaid, but only if the person's overdraft limit were reduced correspondingly and the bank were unable or unwilling to lend the money to another borrower. On the other hand, of course, purchasing power could increase if bank credit expanded, as it has in New Zealand in recent years.

70. If people or firms hoarded their savings, or if financial institutions failed to find borrowers for the savings left with them, or if bank credit declined substantially, the national income would be likely to fall. But, if the accumulation of savings by one section of the community is matched by the spending of another section in excess of its income (either by borrowing money or using past savings) no deficiency of purchasing power to buy the goods and services which have been produced need arise. It should also be remembered that there may be occasions when spending from borrowing or past savings may exceed current voluntary savings, so that the national income will thereby increase.

Displacement of Men by Machines

71. It was claimed in Miss King's submission that one of the basic problems facing the world is that men are constantly displaced by machines, and that this must lead to a shortage of purchasing power.

The men cease to earn wages with which to buy the products of the machines, with the result that the machines themselves often have to be stopped.

72. In the first place, of course, this argument ignores the fact that the payments made by firms for machinery ultimately become income in the hands of the workers and proprietors who have assisted, directly or indirectly, in their construction. In other words, if the volume of machinery in use increases, so does the income of the increased number of people who help to make machinery. In many cases also, the invention of new machines creates a new demand for men to service them, to provide the raw materials or ancillary equipment required to construct and operate them, and so on.

73. Secondly, the argument assumes that those who are displaced in a particular firm or industry are (a) unable to find employment elsewhere, and (b) receive no income from the State or other sources if they are temporarily unemployed. We agree that, at times in the past, the problem of unemployment has been quite serious, although we are not convinced that technical change played more than a minor part in causing it. But today, almost everywhere, the attitude of public opinion to unemployment has been radically altered. Governments have accepted responsibility for maintaining full employment, and knowledge of the causes of and appropriate remedies for unemployment has increased. These changes have contributed to the much lower level of unemployment which has prevailed in most industrialised countries since the war than that which persisted in the years between the two world wars.

74. Under examination, the Association's witnesses admitted that the displacement of men by machines was not a problem in New Zealand at present; that, until now, the economic gains from the use of improved machinery had been taken out partly in the form of a higher material level of living, and partly in the form of greater leisure; that for many years full employment would be necessary in New Zealand; and that, if a stage should some day be reached where the full available labour force was not required to produce the goods and services desired by the community, the situation could be met by a reduction in working hours.

The Need to "Monetise the Real Credit" of the Nation

75. Some witnesses presenting written submissions seemed to feel that it was desirable that the volume of money should be expanded until it was equivalent to the value of the capital assets of the country. Traces of this attitude are evident in the submissions of Mr Young who claimed that *"the existence of men, machines, and materials to carry out a public work is an asset. Against this asset a credit should be written to the value of the productive power available. That credit should be equal to the payments out in respect of the public work"*. Mr Young was asked whether he had in mind here a calculation similar to that made by Major Douglas in his *"Draft Social Credit Scheme for Scotland"*. Major Douglas proposed that a money valuation should be placed on the whole of the capital assets of Scotland, including the commercial capitalised value of the population; then financial credit, i.e., money, up to that value could be created by an agency empowered to do so by the Scottish people. A similar proposal was put to the Commission by Mr John Hogan, to provide a *"mechanism through which the community's real credit"* would be *"monetised"*.

76. One difficulty which immediately becomes apparent in adopting a scheme of this kind is that the value of the community's capital assets is dependent on the level of prices ruling at the time the valuation is made. If the scheme were introduced in a period of rising prices, the increase in prices during the year concerned would raise the value of the nation's capital. This would justify an increase in the supply of money, which would intensify the inflationary pressure already existing, which would cause a further increase in prices. This process would be repeated until a crisis was reached. The converse would apply in a period of falling prices.

77. Mr Young, under cross-examination, said that he did not support such a scheme for New Zealand; the scheme for Scotland was, he said, only of academic interest and of no factual value. In his opinion, the writing of credits against any asset must be limited by the over-riding necessity to keep money in balance with production of consumer goods and services over given periods of time. Again, the national survey was necessary to determine whether or not such a balance was being achieved.

78. It became apparent during the cross-examination of Mr Hogan that the national accounts which he proposed would not determine whether an issue of additional money should be made. Even though the accounts showed that the "real credit" of the country was adequate to justify such an issue, the monetary authorities would still have to decide whether, in the prevailing circumstances, their "net profit" should be used for this purpose or merely transferred to reserve. Mr Hogan recognised that *"if you decide to monetise the whole and not increase reserves, then the result of that might be detrimental to the country's development . . . The allocation of that net profit . . . is something which will have to be learned by experience and which will change according to the extent to which the country is engaged in capital development, the extent to which the community is prepared to save from its current income"*.

79. In other words, after undertaking a complicated book-keeping exercise to determine the "net profit" of the nation, the monetary authorities are left with the same problem as they face today, i.e., to determine whether, in the prevailing circumstances, there is too much or too little money in circulation. The "National Credit Account" is of no practical value, in our view, to help them solve that problem.

Conclusion

80. We conclude that the theoretical analyses put to us by various Social Credit witnesses to support the contention that there is a chronic gap are fallacious.

E. ESTIMATES OF THE SIZE OF THE "GAP"

81. During his cross-examination, Mr Young answered questions on certain estimates of the size of the gap which had been made in three Social Credit publications in New Zealand during the past two years.

82. At an early stage of his cross-examination Mr Young said that an estimate of the 1951–52 gap of £193·5 million which had appeared in an election pamphlet of the Social Credit Political League in 1954 *"was not drawn out of the air"*. A *"survey had been made very well by qualified accountants, as far as they could get at the figures"*. He *"would*

not have supported anything that was unsound" but he was "*satisfied from the facts that were produced*" that he "*was on perfectly safe ground*" here. But later he admitted that the statistical work which had been done could not be regarded as competent and that all the estimates which had been made contained serious errors. We examine these estimates more fully in the attached note. (See Note 2 to this Appendix.) After this discussion, Mr Young said that anyone who contended that there was a net gap of £190 million in 1951–52 was a dreamer. He was aware that the table used in the League's pamphlet could be interpreted in that way, but drew attention to the fact that the League had promised to issue only £80 to £90 million of new money. He stressed that no one was in a position to say what the gap was until a national survey had been made.

83. In his final address, Mr Jordan claimed that statements giving estimates of the gap had, in all cases, been the estimates of individual social crediters. "*I should say truly that those statements have never been received as correct by the general body of social crediters, nor by the many who have always . . . objected to those statements from time to time, on the ground that the compilers haven't the necessary information, and on the further ground that the state of full employment and the state of high prices under which our economy has existed during the past few years have indicated that there could not be anything like the amount of gap that has been estimated.*" **It is obvious, therefore, that no reliance can be placed on the estimates of the gap which were considered before us.**

F. DOES THE "GAP" EXIST?

84. As the hearings proceeded, the faith of the Social Credit witnesses in the existence of a gap seemed to diminish.

85. There is a significant contrast between the original prepared submissions of the Social Credit Association and Mr Jordan's final submission as its counsel.

86. In her written submissions, Miss King argued – There is "*. . . a chronic shortage of purchasing power to buy the goods and services produced and liquidate the prices which industry is entitled to charge*". She also remarked, "*This shortage of purchasing power is either a fact or not a fact. For the establishment of a fact we seek evidence and for evidence we go to experience. The evidence of experience is overwhelming*".

87. Yet, in his final address Mr Jordan declared, "*It has been made abundantly clear, both from our submissions and from the evidence that has been given, that we do not postulate a chronic shortage of purchasing power*". And again, in a document sent to the Commission on 5 October he said, "*It is not contended that there is a permanent deficiency in purchasing power, but it is claimed that any serious shortage in purchasing power should be remedied*".

88. Likewise, in his prepared submissions, Mr Young stated, "*The gap exists today, as it has existed in the years immediately past*".

89. Yet, in Mr Young's examination, this passage occurs:

Question: Would you not say the evidence is strongly against any shortage of purchasing power; (that it) strongly suggests an excess of purchasing power in New Zealand?

Mr Young: Up to the last nine or ten months I would say it is correct.

G. CONCLUSION AS TO THE "GAP"

90. The Social Credit witnesses completely failed to convince us that the present system is characterised by a chronic gap. We are confident that, in general, sufficient income is generated in any period to enable the people of the country to buy the finished output retained in the country and the goods and services imported during that period and to cover the costs involved in their production and sale.

91. This does not mean that the level of income or spending is always adequate to enable the best use to be made of the country's resources; nor does it mean that the levels of spending, output, and income never change. As we know, the level of spending, and therefore the incomes of people, may change for a wide variety of reasons. People overseas may decide to spend more or less on our products; people in New Zealand may decide to save a higher or lower proportion of their incomes than before; financial institutions may make credit more or less freely available; the Government may increase or reduce its spending. Thus, while we are confident that, under the present system, there is no inherent shortage of purchasing power, we are fully aware that there is no reason to believe that spending and incomes will automatically be maintained at that level which is in the best interest of the economy as a whole.

92. It seems evident to us that, since the war, spending has generally been excessive in New Zealand in relation to the goods and services available. Certainly some people have had insufficient to buy the goods and services which many regard as providing the basis for a reasonable standard of living; some have suffered considerably from the continually depreciating value of their savings or their relatively fixed incomes. But, for the community as a whole, all the evidence points to an excess of purchasing power. There has been no undue accumulation of stocks; unemployment has been negligible; there has been a very large number of registered employment vacancies; and prices have risen constantly. These things would not have happened if there had been insufficient purchasing power in the hands of the people.

IV. The Social Credit National Survey

93. The only positive proposal maintained throughout our hearings by the Social Credit Association was that a National Credit Authority should be set up to carry out a national survey. The survey would be designed to achieve the following objectives:

(a) To ascertain *"what we do produce and the cost of such production"*.

(b) To discover *"what our nation is capable of producing"* or more specifically *"what it is practically possible to produce in the immediate future, having regard to our manpower and the machines which we have available and can produce within that time"*.

(c) To enable those undertaking the survey and other experts to suggest measures to increase the production of goods and services desired by our people.

(d) To estimate the amount of labour expected to be used on capital and consumable goods.

(e) To establish the relationship between *"the amount of goods and services which are available to the community"* and *"the amount of purchasing power which is in the hands of the people who desire to buy those goods and services"*.

(f) To enable the Authority to recommend to whom extra purchasing power should be issued.

(g) To provide an objective for industry to strive for.

(h) To provide information for the people so they may take an intelligent interest in economic policy.

94. The Association's witnesses envisaged that the survey would be made every year, but that every quarter there would be an assessment of consumer goods available and of purchasing power in the hands of the people. It was not expected that the survey would require a department of officials; much voluntary help would be obtained from various trade organisations. The survey would grow from modest beginnings. At first, attention would be concentrated on deciding what industries should be helped to increase production, and on obtaining an accurate estimate of the balance between goods and purchasing power.

95. The Social Credit witnesses did not seem to appreciate fully that a considerable amount of statistical information is already available on various aspects of production, although many figures appear some considerable time after the period to which they relate. The Association was informed by the Government Statistician that it would not be an unduly onerous task to bring all the available data together, but that a complete census of services would be required to ensure adequate coverage.

96. The questions as to what our nation is capable of producing and what measures the experts would recommend to increase production are linked and can be conveniently discussed together. New Zealand is capable of producing a large number of different combinations of goods and services; experts could probably suggest effective means to increase production in almost every industry in New Zealand, provided capital, materials, and manpower were available. Unfortunately, however, our capacity to produce is limited in relation to what we would like to have, and when our labour and resources are fully employed, expansion of the production of one thing can be achieved only at the expense of a reduced production of another. Our major problem is to allocate the limited volume of labour, capital, and materials available among our many industries in such a way that the various goods and services which we can produce are turned out more or less in the quantities which consumers want to buy with the money they have available for spending. Today we rely mainly on a system of competition among producers to satisfy the wants of consumers, subject to overall control by the State in the public interest. The Social Credit Association envisage a comprehensive national survey and recommendations by experts as to how resources are to be allocated. If this is to be effective, it appears to us that rigid control of the economy in detail would be necessary to ensure that those recommendations of the experts accepted by the Government were carried out. This is wholly inconsistent with the expressed objective of Social Credit witnesses of encouraging a system of free enterprise.

97. So far as the assessment of goods and services available and purchasing power is concerned, the Government Statistician drew the attention of the Social Credit Association during our hearings to the

great difficulties involved in the statistical measurement of the availability of services. He also said that it was difficult to value goods at various points of the distributive process and to separate capital from consumer goods in assessing the value or volume of goods available for use. We have already commented in our discussion of the gap on our difficulty in deciding what is meant by "purchasing power in the hands of people desiring to buy". **In the absence of a clearer concept, we do not recommend a survey of the type suggested by the Association.**

98. However, we do see merit in many of the basic ideas underlying this proposal for a national survey. We agree that it is important that the Government should actively foster research into the natural resources available in New Zealand and assist our various industries to increase their efficiency. We share the view of the Social Credit Association that men and resources should not be idle because people have insufficient incomes to buy the goods and services which are capable of being produced by those men and resources. Now that the Government has assumed responsibility for ensuring as far as possible that this shall not happen, and to enable it to avoid the alternative danger of inflation, it is essential that it should be fully aware of current developments in the economy and be in a position to make reasoned estimates of probable future trends, so that it may make timely and appropriate adjustments in its monetary and fiscal policies. To this end, we set out in our report proposals designed to foster more research into the operation of the New Zealand economy and to secure the extension and more rapid production of certain statistical series. We feel that the adoption of these proposals would go a long way towards achieving the objectives which the Social Credit Association had in mind in proposing its national survey.

V. The National Credit Authority

99. Mr Young in his submissions proposed that a National Credit Authority should be set up to carry out the national survey and to *"direct the amounts of national credits to be written from time to time to the credit of the nation"*. At first Mr Jordan said that Parliament would surrender to this Authority the power of determining the amount of free credit. In our view, it would be most undesirable for any Government to set up a body which was superior to itself in controlling the country's money supply.

100. By the time our sittings concluded, the Association appeared to have changed its views on this point, for Mr Jordan said in his final address: *"It is essential that this authority shall be answerable to the people and to Parliament"*.

101. We consider elsewhere in our report whether it would be desirable to set up a fact-finding and advisory authority of the type proposed by the Association.

VI. Reform of the Monetary System

102. To carry out Social Credit policy it would be necessary, according to the Social Credit Association's witnesses, that *"the beneficial ownership of financial credit"* should be *"vested in the community"*. In the opinion of the Association, as advanced by Miss King, *"the banking system in its exercise of the vital function of the creation and cancellation*

of financial credit" should be *"in the nature of a trustee for the people and its claim to own the credit it deals in"* is *"usurpation of the most important and powerful social asset the community possesses"*.

103. Mr Jordan, on the other hand, committed himself to this statement in his final address: *"We do not allege . . . that the banks have usurped the State's prerogative to create money. We allege that they did and had until the passing of the Reserve Bank Act . . . but we can see that nominally at least now, the control of money is in the hands of the Government"*.

104. As explained elsewhere in this report, it is clear that the Government through the Reserve Bank can, if it wishes, control the operations of the trading banks. Further, it can, if it wishes, create and destroy money through the Reserve Bank. What then becomes of the Social Credit Association's contention that the *"beneficial ownership of financial credit"* should be *"vested in the community"*?

105. Under a Social Credit regime, as envisaged by Miss King and Mr Young, the banks would be *"tied to certain limits for the creation and lending of money"* (as indeed they are today), but, in general, they would function much as they do now. Advances would not be reduced and interest would still be charged on them.

106. The issue, therefore, seems to be finally resolved in Miss King's answer to this question: "*. . . would the only difference* (in the monetary system) *between what you want and what now exists be the issue of debt-free money?"* Miss King: *"I think, yes, it would come down to that"*.

VII. The Issue of Debt-free Money

107. It is difficult to discuss the proposals for monetary reform put forward to the Commission by the Social Credit Association because of their provisional nature. In the first place, apart from the rather nebulous proposal to restore to the people the ownership of financial credit (discussed above), it was clear that the Association envisaged no change in the existing monetary system unless the national survey disclosed a gap. The Association's witnesses stressed that they did not share the view that money could be issued purely on the basis of Social Credit theory as distinct from the economic facts, for it was recognised that if there were no surplus supply of goods and services and no prospect of an immediate increase, a large sum of extra money would cause serious inflation. They were not in a position to say what amount of debt-free money should be issued at the present time. That would depend on the size of the gap which could be determined only as the result of a national survey. As we have seen, however, their faith in the existence of a gap seemed to diminish as our hearings proceeded.

108. In the second place, the witnesses for the Association did not wish to be irrevocably committed to any particular method of closing any gap which might exist. However, it was suggested in the submissions that, if a gap existed, "debt-free" money might be issued for the purpose of:

(a) Paying price subsidies to retailers who would reduce their selling prices to agreed figures.
(b) Reducing taxation.
(c) Paying increased social security benefits without taxation.
(d) Paying for public works of a non-commercial nature.

109. Miss King also considered that, if the situation permitted, it would be appropriate to issue debt-free money to repay Government loans as they fell due and to subsidise the cost of housing. Both she and Mr Young thought that the National Credit Authority might issue debt free to the Government the money necessary to make loans to those building a house, although those getting the housing loans would be expected to pay interest at ruling rates and repay the loan, since it would be unwise to disturb existing methods unduly. Moreover, it was envisaged that debt-free money might be used to sustain the incomes of farmers should export receipts fall and for the purpose of training men displaced by changes in consumers' tastes.

110. On financing the commercial works of Government, the attitude of the Social Credit witnesses was rather confusing. Miss King thought that such works should be financed by a *"creation of national credit"* issued to them *"without the incurring of an addition to the national debt"*. But she foresaw that, though the community, via the Government, would not be placed in debt as a result of Government works, the particular department or agency undertaking the work would owe the money to the community. Under examination, it appeared that she envisaged the sale of shares in the undertaking, but this was not at all clear. Mr Young said he did not regard borrowing for commercial works as an injustice, because he felt that, where the State was in competition with private enterprise, it should compete on equal terms. He agreed with Miss King that money for commercial works might be created by the Reserve Bank, but felt that it should be repayable with interest. However, he regarded the Railways and the Post and Telegraph Department as public services which should receive finance debt free; he would also make it available for hospitals and for the capital works of local bodies. Nevertheless, he stressed throughout that the issue of any debt-free money was dependent on the existence of a gap as revealed by the national survey.

111. Other witnesses were so convinced of the existence of a chronic gap of very large dimensions that they made no mention of the necessity for a survey, and some went so far as to say that all Government expenditure should henceforth be financed by debt-free money instead of by taxation and borrowing. Indeed, one witness argued that *"too much purchasing power is mathematically impossible"* and that *"so long as there is debt to liquidate, there is room and need for the creation of debt-free credit to cancel it"*.

112. As we point out in our report, there is no technical reason why the Government should not require the Reserve Bank to grant it debt-free advances. The question is whether it is desirable in the national interest that this should be done.

VIII. Finance for Production

113. It is evident that the Association's witnesses envisaged little, if any, change from the existing system in the provision of finance for private production. This conflicts with much Social Credit literature, which commonly condemns the charging of interest, particularly on bank loans; opposes "debt finance" in all its forms; and argues that the credits required to finance production should be supplied not from savings which have no economic virtue, but by new credits. Some writers go so far as to

envisage the complete abolition of debt and interest, e.g., Mr A. E. Willyams, a member of the Dominion Executive of the Association, in his book *Social Credit Is For Me* says, *"If Social Credit is not intended to get people out of debt and keep them out, it is not worth consideration. No debt, no interest – usury will cease to exist"*. Similar views were expressed in several submissions to the Commission.

114. Mr Young said he and his Association regarded such views as *"rather starry-eyed"*. They agreed with all those who maintained that this country had been built up by hard work and that it would only be maintained and extended in the future by hard work. There was no intention, he claimed, in responsible Social Credit quarters of issuing money against the air. Under a Social Credit Government, debt would not be abolished between individuals, or between the State and the individual although, if possible, they would like to see the Government obtain its own financial requirements without incurring indebtedness to do so.

115. Mr Young agreed that the possibility of borrowing fairly large sums of money through the issue of shares, debentures, and mortgages enabled private individuals, singly or in combination, to control expensive establishments like a factory, a shop, a bank, a farm, or a home without completely owning it. If that type of debt were abolished, either the accumulations of capital necessary for modern production could not be built up or all finance would have to be provided by the State. This latter course would be inconsistent with the Social Credit Association's support of private ownership and private enterprise.

116. Most Social Credit witnesses (including Miss King) obviously had mixed feelings about the economic virtue of savings; one, indeed, said *"Saving is worse than a virtue; it is a vice"*. On the other hand, Mr Dodds, on behalf of the Board of Promoters of New Zealand Incorporated (a Social Credit organisation), regarded private savings as *"the foundation upon which a Social Credit economy must rest, because Social Credit is a policy which can operate only within a system of private enterprise; and private enterprise is that system in which savings are made by people foregoing the purchase of consumer goods and using the money so saved to acquire shares in the capital of companies, or to set themselves up in business on their own account"*.

117. Mr Young declared that there was no intention of interfering with savings. He opposed the suggestion made on page 68 of Mr Owen's book and by some other Social Credit witnesses that all future production should be financed from new bank credit rather than from savings, because he felt that it would be unreasonable to prevent a man from using his savings in production if he so desired. The Association, according to Mr Young towards the end of his evidence, did not accept the view that there was no economic value in savings. He acknowledged that, under the present system, if people decided to save no longer, but to spend all their incomes on consumer goods, there would be a fairly wild inflation of prices. He was satisfied that the savings of the people would be protected under a Social Credit regime – if anything, he thought, they would appreciate in value. (We discuss this contention later.)

118. As far as interest was concerned, Miss King said that many social crediters regarded it as iniquitous. And the evidence of most of the social crediters who appeared before us confirmed this. Again, Mr Dodds was

an exception. He regarded debt as *"the normal process of making use of savings"* and could see *"no fault in interest – it provides somebody with income"*.

119. Miss King considered that most social crediters realised that interest could not immediately be wiped out without considerable disturbance, and were therefore prepared to tolerate it in the meantime until conditions evolved to the point at which it would naturally disappear. It was pointed out to her that, if the Government no longer borrowed from the public for capital projects but financed them from debt-free money, the people and the financial institutions with which they deposited their savings would be denied what was now a major source of investment; as a result, it was certain that all rates of interest would be reduced. Miss King thought it would be possible for existing rates of interest to be fixed by decree; but when she was shown some of the difficulties involved in fixing a minimum interest rate, she admitted that she had not thought through that aspect of the problem.

120. Mr Young was also disturbed by some of the implications of a substantial reduction, or the abolition, of interest. He recognised that the use of debt-free money by the Government would have a depressing effect on interest rates; but he thought that if the public wanted a means of investing some of their money which could not be placed in private industry, a channel could be provided in the Post Office at $2\frac{1}{2}$ to 3 per cent. When he was reminded that the Post Office Savings Bank would no longer be able to invest in Government securities, and was asked where the bank would obtain the money to pay interest to depositors, he suggested that it be met out of Government revenue, perhaps from debt-free money if the gap were sufficient to justify such a payment.

121. This, of course, is merely one of the problems which would arise if interest were abolished or drastically reduced. All financial institutions would find it necessary at least to increase their charges and premiums steeply, and possibly to suspend their operations; the main sufferers would be those who had left deposits with or paid premiums to them. The incentive to lend to others would be drastically reduced and one of the foundations of a society based on private ownership would thus be severely weakened. The prices of capital goods from which a profit could be made or a rent earned would be inflated – unless, of course, the State stepped in to allocate the existing capital goods and control the production of new ones. It seems rather anomalous that objection should be taken by many social crediters to a man's lending his savings at interest but none to his buying property with them and renting it, or to his buying a business, hiring a manager, and living on the profits.

122. That Mr Young was aware of some of these problems became obvious later in his evidence. He envisaged a gradual reduction of interest rates – and he hoped that they would be reduced over the years to *"the cost of providing a service"*. But he did not want to abolish interest, because he could see no reason why people who saved, and wished to invest, should not be able to do so. As he said in a later submission: *"If the owner or part owner of commercial, agricultural, or other capital should decide to sell his capital, this means in effect that he exchanges his capital in the form of property for money. It is therefore envisaged as just, that moneys for investments being the proceeds, as it were, of assets, should carry some interest as profit, the equivalent*

of rent for the assets, if the assets had not been sold". As with private debt and savings, he did not foresee much change in interest rates under a Social Credit regime from the present system, at least in the near future.

123. Finally, it might have been expected that Social Credit policy would have envisaged the disappearance of the trading banks, to whom much odium is attached in Social Credit literature. But, as indicated earlier, the witnesses for the Association envisaged that, in general, the trading banks would function much as they do now. They would be *"tied to certain limits for the creation and lending of money"*, but as far as the provision of finance for production was concerned, it was only when the trading banks and private persons and institutions failed to provide *"adequate finance"*, that the National Credit Authority would be expected to step in to supply the deficiency, and then probably *"through the Bank of New Zealand"*. Again, therefore, the Social Credit Association wishes to make no radical departure from the existing system. Whether, in fact, the Social Credit proposals could be adopted without radical changes in the existing system, we shall consider a little later.

124. The above discussion should indicate why we do not recommend any attempt to abolish debt or interest, as was suggested by many witnesses. In particular, we feel that such an attempt would ultimately result in the disappearance of private ownership – a result which very few of the social crediters seemed to want. (See also Appendix C, Section III, on these questions.)

IX. Should the Government Tax and Borrow?

125. Several witnesses declared that it was sheer folly for the Government to tax or borrow as much as it did today. According to one witness, *"none of us live on a standard of living that we would enjoy if we were given adequate purchasing power"*. *"Debt-free money for all Government expenditure"* (which in 1954–55 amounted to about £260 million) would *"add to the incomes of the consuming public"* but *"not add to costs as debt money does"*. It would *"enable the producers to recover the costs of production and so run at a profit instead of at a loss"*.

126. As we have indicated above, the witnesses for the Social Credit Association were much more cautious than this, but their evidence revealed vestiges of a similar attitude to taxation and borrowing. Miss King envisaged the abolition of debt and taxation as an ultimate objective, but felt that *"a certain amount of taxation"* was necessary at present. In her submissions she said that governments should not borrow and she quoted with approval a statement made by Dr Schacht in the 1930's that *"money doesn't have to be 'got' nowadays. We simply issue the necessary credit and put men and materials to work"*. Mr Young considered that it had been foolish policy to maintain taxation at a high level and to borrow from the public in New Zealand and overseas in recent years. He claimed that borrowing for public works of a non-commercial nature was an injustice to the nation, and regarded as fallacious the argument that borrowing for public works was an antidote to inflation.

127. Of course, the above views rest largely on a belief that there is a substantial "gap" which it would be desirable to fill by an issue of debt-free money. As we have said previously, all the evidence is against such

a belief. In the absence of a national survey, the Association's witnesses were quite justifiably unwilling to commit themselves on the question of precisely how much debt-free money might be issued, but we were surprised at the amounts which, in the early stages of our proceedings, they seemed to consider it possible to issue in current circumstances without the risk of disastrous economic results. Miss King seemed unconcerned by a suggestion that, through tax reductions, increased benefits, and payment for Government works, £156 million of debt-free money might be issued in the first year of office of a Social Credit Government. Mr Young first spoke with approval of an estimate of a gap of over £190 million for 1951–52, but later denied that he ever contemplated a net gap of that extent and drew attention to the fact that the 1954 proposals of the League involved an issue of only between £80 million and £90 million of new money.

128. Any Government which issued £80 to £90 million of new money in order, say, to enable taxation to be reduced or social security benefits to be increased, would still cause very serious inflationary effects in an economy where the labour force was fully or more than fully employed, as it has been in New Zealand in recent years. The effects would become disastrous if a similar issue were repeated in succeeding years, as it would be if the tax reductions or increased benefits which had been given were not withdrawn.

129. Those who make goods or perform services for the Government naturally want payment in money. The Government can obtain this money in four main ways:

(a) By taxation.
(b) By borrowing from the public.
(c) By borrowing from the trading banks.
(d) By creating the money itself, either by printing notes or borrowing from the Reserve Bank.

Obviously, as a short-sighted expedient, the fourth method is the most attractive because services can be given and benefits paid without relieving any elector of his money or making it more difficult for him to borrow from private institutions. But, if we take a long-term view, it becomes apparent that, when resources are fully employed, the creation of money is merely a form of concealed taxation, imposed in a most inequitable manner.

130. Assume for example, that the Government wishes to expand its works programme and requires labour and resources worth £20 million at present prices to carry out the extra work. Since the labour force is already fully employed, workers must be drawn away from the private sector of the economy if the public works are to proceed. If the Government raises the money to pay for the labour and resources by taxation or by borrowing from the public, the community is affected, partly in the form of lower incomes after tax, partly in the form of higher prices if traders manage to pass on some of their tax, and partly in the form of a reduction in the amount of capital available to the private sector. Suppose, however, that the Government pays for the labour and resources by issuing £20 million of debt-free money. Again they will be drawn away from the production of goods or services for the private sector; but, in this case, there will be no reduction of spending power in the hands of private individuals. People will be able to spend as much as before, but

there will be less consumers' goods and services available for them to buy. In other words, the spending power of the community as a whole has been increased by the issue of debt-free money, but the total of capital and consumer goods available cannot be increased. In this situation, extra competition for the available goods and services must drive up their prices, unless the Government can induce the people to save much more than before. But, especially in peacetime, there is a limit to the extent to which people are willing to build up their savings balances. Without such saving, the Government will obtain its requirements at the cost of a substantial rise in the prices of consumer goods and services. And this initial decline in the value of money would probably result in claims for higher incomes which, if granted, would still further increase costs and prices. The process of inflation would have begun.

131. To summarise, if production is already at a maximum, the Government can acquire more resources only at the cost of a reduction in the goods and services available to the private sector. This being so, the private sector must accept a cut in its purchasing power over goods and services. To us, it would seem more just and equitable that the cut should take place through a system of taxation based on the people's ability to pay, plus a certain amount of voluntary lending to the Government, than through a rise in prices which must hurt most those who are least able to increase their incomes, and who have built up savings, in many instances at some sacrifice.

132. Thus, in the conditions which have ruled in New Zealand since the war, we do not agree with Mr Young's view that *"borrowing for non-commercial public works is an injustice"* and that *"the argument that borrowing for public works is an antidote to inflation is fallacious"*. His view might have a certain amount of merit if, as he seemed to think at one stage, the great bulk of the money subscribed to Government loans came directly or indirectly from trading-bank credit. But the figures quoted earlier, showing the holdings of the public debt, indicate that this is not so. Mr Young himself admitted later in his evidence that the tax and loan money used for public works came, in the main, from the existing supply of money. However, he insisted that *"money created for public works would no more cause inflation than money borrowed for public works"*. Yet he had agreed that, if the money were created, additional money would be issued and the money which would otherwise have been borrowed for public works would remain in the hands of individuals or firms to spend elsewhere in the economy. Total demand for goods and services must surely be higher in this case than when existing money is lent to the Government.

133. Mr Young also insisted that *"borrowing for public works of a non-commercial nature is an injustice to the nation"*. But he later said that it was *"only possible to obtain justice so far as practicable"*; that inflation would be a greater injustice to the nation than borrowing; and that, as a last resort, he would borrow rather than cause inflation. He stressed that the issue of debt-free money, even for non-commercial works, was dependent on the existence of an ascertained gap; he would not issue debt-free money for public works if sufficient money was available for investment from savings. Mr Jordan also said that, if the effect of issuing any money for public works would be to create a state of inflation, a Social Credit Government would have to rely on taxation.

134. Nobody likes Government borrowing and taxation for their own sake; but one of the primary duties of Government is to use these measures so as to ensure that the total spending of the community is kept in balance with the resources available at current prices. The above statements indicate that, at least towards the end of our hearings, the Social Credit Association's witnesses had begun to appreciate that taxation and borrowing are not unmitigated social evils, as we were told by so many other social crediters, but that they have a positive role to play in preventing inflation.

X. Social Credit and Inflation

135. The preceding section indicates that the witnesses for the Social Credit Association recognised that it was possible for an excessive issue of money or credit, and excessive spending, to cause inflation. They also said that they appreciated the evil effects of inflation; Mr Jordan said that the Association realised that an *"indiscriminate issue of money"* would *"ruin any system"* and *"never bring the efficiency and the justice that we seek to introduce into the economy of this country"*.

136. But a high level of spending played almost no part in the diagnosis by Social Credit witnesses of the causes of the rise in prices which we have experienced in New Zealand since the war. Mr Young attributed this mainly to increased import prices, increased taxation (which he implied was a reflection of increased indebtedness), and the effects of the consequential demand for wage increases. He would not agree that the increased prices we had received for our exports had been a cause of inflation.

137. While witnesses from the Treasury, Reserve Bank, and trading banks had all agreed that there was an excessive amount of money in circulation in New Zealand at the time they were speaking, Mr Young (although he was not completely consistent on this point) thought that there was insufficient money and that it would be foolish to take any measures to curb spending. In fact, with proper safeguards, the creation of debt-free money would, he thought, have made things better and costs lower. This is a very distorted view of the inflationary process. Traders could not pass on increased import prices and taxes or pay higher wages unless the public were able and willing to spend more than before.

138. The faith shared by most Social Credit witnesses who appeared before us that the issue of extra money would improve things in a period when resources were already fully employed seems to rest on several fallacies which are examined below:

Existence of a Chronic Gap

139. For most of the witnesses, this faith rests on the theory of a permanent "gap", for which we could find no justification.

No Difference Between Creation of Money and Taxation and Borrowing

140. Although the witnesses for the Social Credit Association did not fully share the views of some members of their movement that there was no inherent difference between the effects of the creation of new money on the one hand and taxation and borrowing on the other as a means of financing expenditure, they retained vestiges of this view, which we have criticised in the previous section.

Possibility of Spectacular Increase in Production

141. The social crediters seemed to foresee the possibility of a much more spectacular rate of increase of productivity than appears to us to be practicable in normal circumstances. The Association could not agree with the assertion in Mr Owen's book that *"two to four hours labour a week for men during twenty-five years only of their lives is sufficient to provide the total population with a very high standard of living and with complete economic security for all"*. But Mr Young envisaged an annual rate of increase of production of 10 to 15 per cent, although even between 1947 and 1954, when the rate of increase of productivity was high in comparison with pre-war figures, and also high by world standards, production per man-hour in New Zealand increased by only 2·4 per cent per annum. Indeed, in the last four years, the increase in production per man-hour has averaged less than 1 per cent per annum.

142. Asked why it was expected that production would increase so much more rapidly under a Social Credit regime, Mr Young said that, in the first place, people would have an incentive to work harder as a result of reductions in taxation; secondly, that producers would be encouraged by the *"better and surer market"* which would exist; and, thirdly, that the labour force would be increased by about 50,000 people by the removal of the means test for age benefits. In the absence of any research into the effects of taxation on incentives to work in New Zealand, it is impossible to reach any definite conclusion on Mr Young's first contention, but there is certainly no evidence to prove that reductions in taxation would achieve the results which Mr Young expects.

143. As far as the *"better and surer market"* is concerned, a major problem in recent years in New Zealand has been the ease with which manufacturers and traders sell their wares, so that they have been in a position to compete vigorously with one another for the available men and resources, knowing that they could pass on in prices the higher wages, or other costs which they have found it necessary to meet. In other words, the consumer has suffered because the market has been too "sure". Large issues of debt-free money would greatly aggravate this state of affairs. On this point, Mr Jordan quoted a letter from the New Zealand Manufacturers' Federation saying that production could be increased if there were a ready market, and that costs and prices would be lowered in many cases, if labour were available and restrictions against the working of shifts lifted. Mr Ashwin aptly described this observation as a *"blinding flash of the obvious"*.

144. We agree that there might be quite a substantial increase in the labour force if means tests were removed for age benefits. We doubt, however, whether the additional number would reach 50,000 as suggested by Mr Young, especially if his proposals to increase the benefits substantially were adopted. In any case, this could affect the rate of growth of production for only a year or two, and even in the first year could not increase production by an amount commensurate with the injections of money which were clearly contemplated under the original proposals of the Social Credit Association. In addition, Mr Young agreed that means tests for age benefits could be removed under the existing system, with similar results, if the Government so desired.

145. To sum up, we cannot accept Mr Young's assertion that *"nothing is impossible once you shake these financial leg-ropes off"*; nor

can we agree that, in the absence of revolutionary new techniques, production can be annually increased at anything approaching the rate of 10 to 15 per cent. **In our view, the factors limiting our ability to increase production since the war have been physical and psychological, not monetary.** Virtually no persons able and willing to work in New Zealand have been unemployed. No doubt people could have worked harder or done more to improve their capacity to make the best use of our inherited capital and natural resources. But that could have been achieved only through a change of attitude, not by putting into circulation large amounts of new money. More money will not of itself produce more goods.

Wartime Experience

146. Several Social Credit witnesses were most impressed by the fact that large quantities of money had been created in various countries during the war without driving up prices substantially. But we must remember that, in wartime, people were prepared to accept strict control over prices, wages and other incomes, rationing of foodstuffs, raw materials and equipment, and even direction of labour. Mr Young agreed that he would not like to see wartime control permanently maintained. In addition, in wartime, people accepted for patriotic reasons the necessity for shortages of goods and restraint in spending. These reasons lose driving force in times of peace. It is unrealistic to apply the experience of wartime to a peacetime economy.

Transfer from Capital Works to Consumer Goods Production

147. The Association's witnesses envisaged a substantial transfer of men and resources from capital works to the production of consumer goods. We agree that, if this were done, there would be a reduction of inflationary pressure. The difficulty is to select capital works which should be curtailed. The Association made no positive suggestions in this respect.

Cancellation of Debt-free Money

148. Miss King and Mr Young argued that the large sums of debt-free money which they had in mind would be issued in small quantities over the year and would be cancelled almost immediately after they had been issued. Mr Young recognised that the question of cancellation of any debt-free money issued by a Social Credit regime was *"of the utmost importance"*. In fact, he went so far as to say that it was *"fundamental"* to the Social Credit case. Recognising its importance, the Commission spent many hours examining witnesses for the Social Credit Association on the subject.

149. Miss King was completely unconvincing in her attempts to explain how the large amounts of debt-free money, once issued, would go out of existence. The Commission was first told that *"as consumer purchasing power, it* (money) *loses its virtue as soon as it is spent"* and that *"a consumer, by buying final goods, can take goods off the market and finally cancel the costs involved and included in their price"*. But she admitted that money issued remains in circulation, and is available for some one to exercise command over goods and services, until it goes back to its origin; the money remains in existence, she said, *"unless it is*

paid to extinguish a debt, and in a sense there is at present no technique for meeting what we call debt-free money, except in so far as the community always owes more debt to the banking system under present circumstances than it receives the means of paying".

150. From Miss King's attempts to show us how debt-free money would be cancelled, we were convinced that there would be no such cancellation by the means she described. Apparently Miss King has experienced trouble elsewhere in attempting to elucidate this matter, for she referred to the pains she had been at "*to try to understand the difficulties which the ordinary money mind and the business mind have in dealing with these things*".

151. We were not surprised when Mr Young told us that Miss King, "*not being too clear in the exposition herself*", had led us "*rather round the garden path or at least caused quite a considerable wandering round*". But his own explanation was no more convincing. He said that the "*same system of creation and cancellation*" would apply in a Social Credit economy as applied today, where "*the granting of an overdraft and the exercise of that by a borrower is creation of new money. And conversely, when that money is repaid, that money is automatically cancelled*".

152. We would make two comments on the foregoing statements. First, under the overdraft system in operation in New Zealand, repayment of an advance may, taken in isolation, lead to a reduction of the money supply as defined by the Reserve Bank. But the volume of purchasing power available remains unchanged unless, at the same time, the customer's overdraft limit is reduced – for he can draw cheques up to that limit at any time.

153. Secondly, there is an important distinction between bank advances and the issues of debt-free money envisaged by the social crediters. A bank advance is a loan, repayable by the borrower; an issue of debt-free money would not be repayable at all. It could, of course, be used to repay existing advances, but, if the large amounts of debt-free money which Miss King and Mr Young considered it possible to issue were used to repay advances, all present overdrafts would soon be paid off and this method of cancellation would no longer be available. However, Mr Young insisted that there would be no reduction of bank advances under Social Credit. Therefore any issue of debt-free money would increase the money supply by an equivalent amount, unless some of it were used for imports – but naturally our reserves of foreign exchange limit the extent to which this could be done.

154. If £80 to £90 million of debt-free money were issued in the first year of office of a Social Credit Government, the volume of money would by the end of the year have risen by about one-third. Even if the tax reductions and increased expenditure of the first year were merely continued and no further concessions made, a similar increase in the volume of money would occur in each subsequent year. Inflation of the money supply on this scale could not fail in the prevailing circumstances to lead to spectacular price increases and eventually to the destruction of our money system.

155. Mr Jordan, Mr Young, and one or two other witnesses with Social Credit affiliations recognised one other method of cancelling debt-free money; i.e., its retirement from circulation by taxation used to repay

debt to the central bank. Mr Jordan said that this would be necessary *"only in the event of some major upheaval or unforeseen circumstances, such as war, or earthquake"*. An attempt to issue £80 to £90 million of debt-free money per annum would, we are certain, create an inflationary situation which would have to be classed as a *"major upheaval"* – and the Social Credit Government would thus be forced to raise taxation and reduce expenditure once again to retire the surplus of money from circulation.

The Price Subsidy

156. In such a situation, Social Credit's other major *"safeguard against inflation"* – the price subsidy – would be of little avail. This measure, said Mr Young, would avoid any disastrous effects from the over-issue of money and *"prevent any pressure on prices upwards"*. But, on examination, the system of *"voluntary price regulation"* proposed would be quite ineffective if the money supply were inflated.

157. The scheme outlined to us by Miss King and Mr Young involved consultation between the Government and business, at which the businessmen would be asked to say what they considered was a reasonable margin of profit for the purpose of determining a fair market price. If they would then sign a contract to sell at a given percentage below the fair market price, the Government would subsidise them with debt-free money to the extent of the price reduction. If costs rose, prices would automatically rise to maintain the margin. Therefore, what is stabilised under this scheme is not prices, but the profit margins of traders dealing in the subsidised goods.

158. Mr Young was unable to say whether the subsidy scheme would extend over the whole range of traded goods and services and over rents and property values; or whether it would be confined to a few essential goods and services – this would depend partly on the size of the "gap" to be filled at the time. He agreed that, if only a few goods and services were subsidised, any excess purchasing power could be used to buy unsubsidised goods and services and the tendency would be for the prices of those goods and services to be raised. But even if everything bought and sold retail were brought within the scheme – and that poses administrative problems of great magnitude – it would still not provide a safeguard against a rise in prices. For traders and manufacturers would find it easy, in a situation of excessive money supply, to sell all they could produce and most would be eager to expand their turnover to increase their total profits; on the other hand, consumers, in this situation, would be faced with shortages of goods and services and they would not be unwilling to pay, and might even offer, higher prices. Therefore, there would probably be some dealing "under the counter" at higher than regulated prices, but more importantly, sellers would have every incentive to bid against one another for the limited supply of labour and resources available, even if this did involve higher costs. For, under this scheme, higher costs could always be passed on in prices; in fact, since the trader is allowed his costs plus a percentage margin, he has every incentive to inflate his costs in order to increase his total profits.

159. In reply to a suggestion that this might happen, Mr Young said that, if there were very grave shortages of goods, he would immediately ration to ensure equitable distribution. Also, if there were a steep increase

in costs, there would be a detailed investigation of the causes, and remedies (presumably much stricter controls over prices) applied to stop the increases.

160. Of course, excessive spending may take place, due not only to an increase in the volume of money, but also to more intensive use of the existing supply. For example, Mr Young was asked how he thought a Social Credit Government would deal with a situation where many people, fearing a rise in prices in the future, decided to spend more than their incomes by borrowing and/or drawing on their savings, thus creating excessive demand for the goods and services available. His answer was that, in such circumstances, it might have to resort to a policy similar to that which he considered appropriate in wartime, i.e. (a) appeals to save, (b) taxation to the extent thought just, (c) if necessary, freezing of certain money, and (d) rationing of essential goods, in addition to the price regulations which would already be operating.

161. Appeals to save would be of little avail if people expected the value of their savings to depreciate as the result of an excessive issue of debt-free money or if they feared that their savings might be frozen. In fact, if people generally came to fear the freezing of their savings, there would be a grave possibility of a "run" on the banks and of a general pressure to convert money into assets which the Government was unlikely to commandeer. To counter this, a Social Credit Government would have to adopt a policy of "bureaucratic regimentation" much more severe than this country has ever experienced in the past. Yet many social crediters complain of the degree of control existing today.

162. To sum up, we feel that an attempt to issue new money on the scale which most Social Credit witnesses seemed to consider possible and desirable would be certain, in circumstances where resources were already fully employed, to lead to a serious inflation of prices and force the Government either to withdraw the concessions given or to adopt direct controls which would be so widespread and so severe that they would be quite unacceptable to the people of New Zealand.

163. The Association's original submissions were clearly based on the assumption that the supply of purchasing power in New Zealand has been and remains inadequate. But we can only conclude from Mr Jordan's final address that the Association had by then come to the conclusion that New Zealand was suffering in current circumstances from excessive spending and an excessive supply of money. Indeed, Mr Jordan appealed to the Commission for a recommendation *"that the war against inflation be carried on"*. In addition, both Mr Young and he, in a supplementary submission made towards the end of our hearings, said that, in a period of inflation, they were not opposed to the methods specified from page 63 onwards of the Reserve Bank submissions, i.e., credit control by raising the reserve ratios and discount rate, and selective advance control. Mr Jordan stressed, however, that public co-operation in restraining spending and the possibility of increasing the production of consumable goods and services should not be overlooked as additional methods of control. These remarks indicate clearly the extent to which, by the close of our hearings, the Social Credit Association representatives had departed from the fundamental principles of their original submissions.

XI. Debt-free Money in the Future

164. As production and population grow, more money will be needed. Why, it may be asked, should not all the extra money we need in future be provided debt free to the Government, as many witnesses suggested, rather than through interest-bearing loans from the trading banks to industry? There are several reasons why such a course should not be followed.

165. We agree that there may be situations where what is primarily required is a direct increase in the incomes of consumers to absorb increased production and then it may be appropriate to issue additional money to the Government through the Reserve Bank; at other times, the primary need may be additional credit to assist producers to produce more, and we think that such funds are more appropriately provided by the trading banks who are in direct contact with individual producers and more conversant with their problems.

166. We do not favour undue reliance on the provision of new money through the issue of consumer credit; it seems to us that such a policy would mean that the community would receive too high a proportion of its income in the form of benefits from the State, unrelated to productive effort, and this would, in our view, unduly weaken the incentive to produce which is still so vital to our future progress.

167. It is an illusion to believe that costs and prices would be lower if all the extra money required as population and production expand were issued debt free through the Government to the people, rather than in the form of loans to industry and commerce by the trading banks. Firms need more working capital as their operations expand, and this necessity remains whether or not debt-free money is issued. Today, they obtain part of any extra working capital required by borrowing more from the banks. If, under a Social Credit regime, the banks could not expand their loans, the firms would have to obtain additional working capital either by raising their prices, increasing their capital, or borrowing at interest from other sources; no reduction in costs or prices could be expected.

168. If the Government adopts a policy of issuing debt-free money to pay for its capital works, it enters into very one-sided competition with the private sector of the economy for the labour and resources available, and the community gets a completely false picture of the real cost of such works. In our view, there is grave danger that this false picture would lead to pressure upon the State to take over from private firms services, which, in terms of real resources used, it could run no more efficiently, but which, by reasons of its favoured financial position, it could supply more cheaply in money terms, at least in the short run.

169. Similar considerations apply in the case of the use of debt-free money for the payment of benefits or subsidies. If these must be financed by taxation, there is a potent check on extravagance, in the form of critical scrutiny by the taxpayers who are relieved of part of their income to enable the payments to be made. If it is conceded that benefits and subsidies may be financed by an issue of debt-free money, this check is removed, and the pressure on the Government for extra benefits must increase.

170. Thus, serious objections to reliance upon debt-free money to expand the money supply as population and production grow are:

(a) It would give a false picture of the real cost of Government operations.
(b) There would be pressure for the State to take over functions which it could perform no better than private firms.
(c) It would be very difficult to keep the issue of debt-free money within the bounds of prudence; and
(d) If an excessive issue were made, costs and prices would be driven up very steeply and rapidly.

XII. Insulation of the Economy Against Price Fluctuations Overseas

171. Mr Young, in his submission, claimed that it was essential that those engaged in the farming industries should be *"assured of a price in New Zealand money sufficient to meet the costs under which they must produce plus an adequate return for their own services"*. Discussion centred primarily around the application of this principle in the event of a fall in the prices of New Zealand's exports.

172. Miss King quoted a letter sent by Major Douglas to the Auckland Branch of the Farmers' Union in 1931 advocating that, in such a situation, subsidies should be paid to the exporter so that he could sell overseas at prices 10 per cent cheaper than his competitors in other countries. She said that this could be done in a future recession, finance being provided by an issue of debt-free money. The Commission asked whether this could be regarded as a fair way of competing in overseas markets; did we not object strongly to the disposal of American food surpluses overseas at low prices? Later, Miss King said that she would not favour a subsidy to facilitate the sale of exports as a general policy.

173. Mr Young complained that the support prices proposed in New Zealand for meat and wool were, in his opinion, quite inadequate to cover farm costs and give the farmer a reasonable profit, and that a sharp fall in prices could thus have serious repercussions on the New Zealand economy. He seemed to feel that farmers should be guaranteed a price at approximately the level ruling when he spoke. He was not prepared to extend this principle to other sections of the community. The farmers were the providers of the overseas exchange of New Zealand and their receipts depended on factors beyond New Zealand's control. As such, they deserved special treatment.

174. Mr Young stressed that, under a Social Credit regime, farm prices would be related to internal costs. Presumably then, if overseas prices rose more rapidly than internal costs, some income would be taken from the farmer. When overseas prices fell, he would receive payments sufficient to cover costs plus a reasonable profit. New Zealand's experience in recent years has shown that there are practical and political difficulties in the implementation of such a policy, e.g., it is difficult to arrive at an average cost of production on which to base the payment to farmers and there are always objections to the withholding of funds from the farmers in a period of rising prices.

175. Also, under examination, Mr Young recognised that overseas market trends could not be completely ignored. For example, he agreed that if the market for one product fell off, it was desirable for production

to be switched to more profitable lines. He said that farmers producing the goods whose price had fallen would be encouraged to switch although, pending transfer, they would receive their full cost, plus a reasonable profit, from debt-free money. Farmers would not be directed to change production, but they could not expect financial help to continue if they persisted in producing things which were not wanted.

176. We would observe that market trends overseas could not be ignored completely if the prices of all New Zealand's export products fell drastically. Although, in such circumstances, import prices would be likely to fall also, they would probably fall less than export prices if past experience can be taken as a guide. Thus, each unit of goods exported would be exchangeable for a lower volume of imports than before. The total volume of imports could be maintained for a time by drawing on our foreign exchange reserves, but if the fall in export prices persisted, it would eventually be necessary to reduce imports. Mr Young acknowledged that no administration could prevent a decline in New Zealand's standard of living if this should happen.

177. Mr Young was questioned on the danger of inflationary pressure arising as a result of maintaining domestic incomes while the volume or value of imports fell off. He replied that this could be avoided by *"voluntary price regulation"*, by the use of any surplus reserves of foreign exchange, by some switch of production from capital to consumer goods, and by avoiding an over-issue of money. Towards the end of his evidence, Mr Young said that if the gap was not sufficient to justify financing subsidies out of debt-free money, he would *"tax or stop some other work in favour of this particular purpose the money is required for"*. The statement indicates a notable departure from the fundamental principles of the Association's original case, and the adoption of a view much more in line with current financial opinion.

XIII. Social Credit, International Trade, and Control by the State

178. Both Miss King and Mr Young stated that import selection would be an essential element of Social Credit policy. It would be necessary to prevent excessive spending on imports and to ensure that, if overseas funds were scarce, those imports which were least essential to the New Zealand economy would be excluded.

179. We would make two comments on the foregoing statement. First, a system of import selection would not be sufficient to safeguard our foreign exchange reserves if the money supply were excessively inflated; for such inflation would mean that costs in the export industries would be driven up in relation to prices received for exports and these industries would become less attractive in relation to those producing predominantly for the home market. Unless exports were subsidised, the tendency would ultimately be for the volume of exports to decline, thus reducing our earnings of foreign exchange. At the same time, the demand for foreign exchange would be increased as a result of domestic inflation and the difficulty of administering the controls would be considerably increased.

180. Secondly, this is another of those direct controls by Government to which the Social Credit Association and the Social Credit Political League have declared themselves opposed in principle. Mr Young was unable to point to any control in existence today which Social Credit

could abolish. In fact, his evidence showed that control by the State would be expanded considerably. Not only would we revert to a system of detailed import selection and exchange control, but we would also have comprehensive price regulation and a much stricter control of bank advances; probably control of building, interest rates, and rents; and possibly, in an emergency, rationing plus the freezing of certain money holdings. If the views of those with more grandiose ideas than the Association about issuing debt-free money were accepted by the Government, the country, in our opinion, would soon have to be subjected to even more rigid controls, conceivably even including the direction of labour, in order to hold down costs and prices and preserve a measure of equity in the distribution of the available goods and services.

181. We do not intend in this report to discuss the ultimate objectives of Social Credit but if, as Miss King said, two of the long-term aims of social crediters are the replacement of wages and salaries by a universal national dividend and the abolition of interest, we cannot see how at the same time they could preserve a system of private ownership and private enterprise. The two former objectives are completely incompatible with the third.

XIV. Summary and Conclusion

182. It was apparent from the remarks of counsel for the Social Credit Association in opening his case that the version of Social Credit put before the Commission by the Association was designed to avoid some of the more extravagant features of that put to the electors of New Zealand by the Social Credit Political League in 1954. It was also more cautious than that advanced by most of the other witnesses who appeared before the Commission and who claimed to be social crediters. Even in its original submissions the Association gave us no assurances of the speedy abolition of debt and taxation or of the practicability of the institution of a universal national dividend financed from debt-free money. In the early stages, the representatives of the Association maintained a firm conviction that there was a large gap to be filled between purchasing power and prices, which would justify an issue of debt-free money by the Government to enable taxation to be reduced, subsidies to be paid to retailers, social security benefits to be increased, and non-commercial works to be financed without an increase in the public debt. But no attempt was made to measure the extent of the alleged gap, and under examination Mr Young admitted that all the previous estimates which had been made were full of serious errors. There was no readiness to assert that it was safe to issue £90 million or £190 million of debt-free money at the present time and in fact, in evidence, Mr Young said that it would be a mistake to promise any reduction of taxation or increase in benefits.

183. The original convictions of the Association's witnesses about the gap and its size obviously weakened as our hearings proceeded. Major Douglas's "A + B theorem" upon which most Social Credit literature in the past has relied to prove conclusively the extent of the alleged chronic gap, and which still formed the basis of the representations of some of the other Social Credit witnesses, is now regarded by the Association as being *"of academic interest"* only. In their submissions it was made clear that the belief of the Association's representatives in the existence of a

chronic gap rested primarily on *"evidence from experience"*, namely, the occurrence of depressions in the past and the growth of debt in New Zealand since 1936. But under examination their faith in this evidence practically disappeared; for instance, towards the end of our hearings, Mr Jordan admitted that *"increases in debts, public and private, are neither a measure of the 'gap', nor conclusive proof of it"*. Indeed, he went so far as to say that the Association does *"not postulate a chronic shortage of purchasing power"* and asked us for a recommendation that *"the war against inflation be carried on"*.

184. The only positive suggestion which the Association recommended to us for immediate application was that a National Credit Authority should be set up and a national survey made to ascertain, *inter alia,* whether or not a gap existed. It was clearly indicated that the soundness of the remedy which they proposed for later application – the issue of debt-free money to finance various items of Government expenditure – depended on the demonstration of a gap. Miss King and Mr Young agreed that, if the case for the gap failed, the case for the application of Social Credit failed.

185. No Social Credit witness produced evidence to satisfy us of the existence of a gap, chronic or temporary, at the present time. In fact, as indicated above, the Social Credit Association appeared to have realised by the end of our hearings that New Zealand is currently suffering from an excess, not from a shortage of spending power. In such circumstances, there is nothing to warrant the adoption of Social Credit's financial proposals. We are convinced that implementation of the proposition of some witnesses that all Government expenditure should be financed with debt-free money would result in disastrous inflation.

186. The main submissions made by counsel for the Social Credit Association in his final address were that it was necessary to have a national survey and to set up an authority *"to watch carefully inflation and deflation and to take the appropriate steps in the case of imbalance"*. These recommendations are discussed in other sections of our report dealing with research and statistics and with the co-ordination of policy. The principal surviving variation in the Association's case from generally accepted financial opinion was that, if there were justification in the future for an issue of new money, this should preferably be made debt free to the Government to pass on to consumers or to finance non-commercial works. We do not favour this proposal. To believe that it would reduce costs, prices, and total indebtedness is illusory. Moreover, it would give a completely false picture of the real cost of Government works and would be a potent inducement to extravagance in the granting of benefits and tax concessions.

187. The Association's final views were substantially different from the submissions which the Association originally presented, and from the version of Social Credit advanced by most other witnesses, which followed more closely the traditional doctrine of a chronic gap. It is not surprising that this doctrine should have flourished during a depression. In a period when large numbers of people are unemployed, wages and prices are falling, and considerable stocks of goods are unsold, there is every reason to believe that placing more purchasing power in the hands of the people will improve the operation of the economic machine. But, as changes in the Association's attitude show, it is impossible to sustain

a contention that there has been a general shortage of purchasing power during a period when there has been virtually no unemployment, a very large number of employment vacancies, recurrent shortages of goods and services, and continually rising prices.

188. Perhaps the continuing belief of many witnesses that the issue of large quantities of new money would be beneficial in such a period rests mainly on a confusion between what is good for the individual and what is good for the community as a whole. We know that if, as individuals, we won a lottery or received a substantial increase in pay, we could buy more of what we want. But if an issue of debt-free money for tax reductions or increased benefits gave us all the equivalent of a lottery prize or a pay increase, no-one would be better off at a time when labour and resources were fully employed. The issue of debt-free money in such circumstances would not enable any more goods or services in the aggregate to be provided.

189. The additional money would not remain unspent; nor would it be cancelled out of existence as soon as it was spent as some witnesses contended. We would merely have much more money chasing a relatively constant supply of goods and services. Inevitably prices would be driven up by extra competition for the things which were available for sale. If the tax concessions and increased benefits were repeated in subsequent years, necessitating further issues of debt-free money, the country would be engulfed in a rapid inflation, bringing in its train economic, political, and social problems of a magnitude and severity which it is to be hoped New Zealand will never be required to face.

NOTE 1 TO APPENDIX E

Points of Difference Between Witnesses for the New Zealand Social Credit Association and the Book How Social Credit Works *Compiled by Mr Wilfrid B. Owen*

(Reference paragraph 6 of Appendix E)

190. In view of the difficulty which the Commission found in reconciling the views expressed by witnesses for the Social Credit Association with published Social Credit literature – in particular with the book *How Social Credit Works* compiled by Mr Wilfrid B. Owen, President of the New Zealand Social Credit Political League – Mr R. G. Young, Vice-President of the League, agreed, in response to a request from the Commission, to state concisely the points of difference. These are set out herewith.

191. *How Social Credit Works,* page 29:

> The Social Credit idea is that, under modern conditions, complete employment in Industry is neither possible nor desirable; that the national dividend must progressively replace the wage and salary; that credit must be issued free to consumers to bridge the gap between purchasing power and prices, and that this Consumer Credit shall be the controlling factor in Distribution.

Mr Young:

> Our comment is that that is not practicable in New Zealand, that full employment is necessary and desirable in this country, and that we see nothing in the foreseeable future that the national dividend would replace the wage and salary systems.

192. *How Social Credit Works,* page 31:

Our survey of the principles, theories and policies governing Finance as the agent of Distribution must convince us why they are ineffective in distributing the goods and services provided by Industry with the least trouble to the community. It reveals that the true purpose of an economic system, which is to deliver goods and services to the limit of productive capacity, or the limit of consumptive capacity, whichever occurs first, has been perverted entirely to serve the interests of the Financial system.

Mr Young:

You will remember I disavowed . . . it had been deliberately perverted to that idea.

193. *How Social Credit Works,* page 45:

In New Zealand the Central Bank is the Reserve Bank; that is, the Central Bank belongs to the people and should function for their benefit. To-day it merely functions for the benefit of the private banks and by its control of currency, based, or supposedly based, on a gold and sterling basis, regulates the financial credit of New Zealand.

Mr Young:

We disagree [with the statement that "it merely functions for the benefit of the private banks".]

194. *How Social Credit Works,* page 53:

Discusses the A + B theorem at some length and in some detail. Mr Young agreed that the computation of the gap in the example given was incorrect. He also agreed that the example had no regard to the continuity of production and the continuity of payments out in the course of production.

195. *How Social Credit Works,* page 55, the heading:

"Prices always greater than incomes".

Mr Young:

It should be . . . nearly always greater than incomes.

196. *How Social Credit Works,* page 58:

A word or two about Savings. If Industry distributes £1,000,000 in wages, salaries and dividends, and the recipients save £100,000, it should be evident that goods to this value remain unsold. If this sum is then invested in production it ceases to be available as purchasing power, but creates a fresh lot of consumable goods.

Mr Young:

We are quite willing to concede that money spent in investment is purchasing power for capital goods and so forth. [Money spent on investment] . . . is purchasing power at the time it is spent.

197. *How Social Credit Works,* page 62:

Like most professions and industries the banking system of U.S.A. (and elsewhere) have their "trade journals". The following quotations taken from the *United States Bankers' Magazine* dated 26th August, 1924, would seem to indicate that the decision for a slump was certainly made about this time. The following can fairly be claimed to be an instruction to all banks:

"Capital must protect itself in every possible manner by combination and legislation. Debts must be collected, bonds and mortgages must be foreclosed as rapidly as possible. When through a process of law the common people lose their homes, they will become more docile and more easily governed through the influence of the strong arm of government, applied by a Central power of wealth under control of leading financiers. This truth is well known among our principal men now engaged in forming an imperialism of Capital to govern the world."

Question:

You disown that [the above quotation]?

Mr Young:

Yes.

198. *How Social Credit Works,* page 68:

. . . the general principles on which the necessary reform is based have been laid down by Douglas as follows:

1. That the cash credits of the population of any country shall at any moment be collectively equal to the collective cash price for consumable goods for sale in that country, and such cash credits shall be cancelled on the purchase of goods for consumption.
2. That the credits required to finance production be supplied, not from savings, but be new credits relating to new production.
3. That the distribution of cash credits to individuals shall be progressively less dependent upon employment. That is to say, that the National Dividend shall progressively displace the wage and salary.

Mr Young:

This at the present time is under consideration by the Dominion Executive of the Social Credit Political League for a re-statement. We are not happy with those three.

. . . it suggests arbitrarily that all future production should be financed from new bank credit, not from savings. We think people should have the right to use their savings if they so desire.

There is criticism within our own ranks to some extent that if you took it literally on its face value as actually stated there it would prohibit a man from using his savings if he wished to, which we think is unreasonable.

Question:

At the moment you do not accept them as the three basic principles for reform?

Mr Young:

No, sir. They are being re-stated.

199. *How Social Credit Works,* page 71:

(a) The second principle is: "That the Credits required to finance production shall be supplied, not from savings, but be new Credits relating to new production, and shall be recalled only in the ratio of general depreciation to general appreciation."

As we have shown, the problem of insufficient purchasing power is intensified by the question of savings. These, being a portion of A payments direct to individuals, should help to take goods off the market, but do not.

(b) There is no economic virtue whatsoever in savings, and the orthodox ideas that Capital is dependent on savings are either fallacious or rendered ineffective by the increasing use of Bank Credit. Savings prevent goods valued at a like amount from being sold, and when such savings are reinvested in production they create a new series of costs without generating any fresh purchasing power.

Mr Young:

(a) This is also being reconsidered by the League.

(b) We do not accept that [there is no economic virtue in savings.]

As I say it was done in a hurry and he took this from Stone's book and there was not the close attention given to it that there should have been. It is a warning to us in future to be much more careful in these matters.

200. *How Social Credit Works,* page 71:

The third principle is: "That the distribution of Cash Credits to individuals shall be progressively less dependent upon employment. That is to say, that the dividend shall progressively displace the wage and salary, as productive capacity increases per man hour."

Under the existing system employment is the only means of obtaining purchasing power, and this principle recognises the necessity of providing some form of income other than wages and salaries as machines progressively displace men from industry.

Mr Young:

We think so far as New Zealand is concerned that it is not within the foreseeable future.

201. *How Social Credit Works,* page 72:

For a hundred years the efforts of the scientist and inventor have been devoted to finding new and better processes, bigger and faster labour-saving machines. So successful have they been that it has been estimated that a period of from two to four hours' labour a week for men during 25 years only of their lives is sufficient to provide the total population with a very high standard of living and with complete economic security for all.

Mr Young:

You remember there was a question about these figures. We do not think that those are applicable to New Zealand at all.

202. *How Social Credit Works,* page 73:

When the shackles of the Monopoly of Credit are removed this idea of compulsory work will lose all relation to reality, because it will be impossible to adjust full scale employment to an increasingly mechanised industry. The national dividend is inevitable in a world of progress.

Mr Young:

That is in the distant future. A long way off.

Question:

Some time that you and I will never see?

Mr Young:

I think so.

203. *How Social Credit Works,* page 80:

This dividend, as by the illustrative figures given in our previous lecture, would be of the same total amount as the total of the retail discount, and would be paid by the National Credit Authority direct to individuals either through the Post Office, as pensions are now paid, or direct by cheques.

We do not doubt that both the discount schemes could be put into operation very easily. Only experience and a period, perhaps, of trial and error would determine the easiest and most effective methods of administration.

We think a combination of the two would be necessary. For instance, services such as transport, amusements, and any form of business where tickets are issued, and retail shops selling fruit and perishable goods, where quantities and qualities depend on indeterminate factors, would probably be better served by the second alternative. For the great bulk of consumable goods probably the first alternative is the better, but experience only will determine this.

Mr Young:

The whole page is a matter for consideration and we do not think that any useful purpose would be served, as far as New Zealand conditions are concerned, in discussing the thing.

204. *How Social Credit Works,* page 93:

THE PHILOSOPHY OF SOCIAL CREDIT

During the early days of the Social Credit Movement lecturers laid great stress on the A and B theorem, the Just Price regulating factor and other technical aspects of the New Economics.

Perhaps they overdid this, but it provided a sound and necessary basis of knowledge. In more recent years they have gone to the other extreme and have concentrated on bank-created credit, debt and taxation.

We have long held that the successful teaching of Social Credit as a practical reform must include both these aspects; they are complementary to each other.

But Social Credit is much more than a reform and a change in the financial system; it is a PHILOSOPHY, and experience has taught also that we have not given sufficient consideration at any time to this vital aspect of our teaching.

When we go out to preach Social Credit we find there are two powerful groups opposed to us – one representing conservatism and the vested interests that we may term the Sound Finance group; the other representing the mass of wage and salary earners that we may term the Socialist group.

These groups oppose one another, but they both agree to oppose Social Credit. Each stands for a definite Social and Economic system, and so does the Social Credit group.

Now Douglas, in one of his most important and valuable utterances, has stated that a Social and Economic system represents "the policy of a philosophy," and he defines "policy" in this connection as "action consciously directed towards a given objective."

If we look at the philosophy of Sound Finance we must recognise that the policy directed to make it effective develops into a system akin to Fascism. If we look at the philosophy of Socialism we must recognise that the policy directed to make it effective develops into Communism.

Both of these policies lead to a system of centralised control in the hands of a few – one through finance, the other through bureaucracy.

Both tend to destroy individual initiative – one by debt and taxation, the other by the elimination of private enterprise.

Both represent the will-to-power – one by money control, the other by political and social organisation.

Both believe in policy imposed from above – one by law and necessity, the other by force.

Both suppress individual freedom – one by economic compulsion, the other by economic regimentation.

Both have false ideals of an economic system – one as a means to make profits, the other as a means to provide employment.

Both believe in the Work State – one because it objects to leisure, the other because it conceives work as the only economic security.

Both believe that men exist to serve a system – one because it worships the supremacy of finance, the other because it worships the State as an abstraction.

As Social Crediters we disavow both these philosophies and the policies and systems that grow out of them. They are the enemies of progress and liberty and the negation of the free spirit of man. The philosophy of Social Credit is entirely opposed to them.

Social Credit believes in decentralised control, with the foundations of society laid on the complete independence of the individual. It believes that policy should come from the community through building up from the Individual, not down from the State.

It believes that systems are made for men and not men for systems.

It believes that the future of the world lies in co-operation, but only in the co-operation of reasoned assent, not in the forced co-operation of regimentation. It believes that the economic activity is simply a functional activity of men and women in the world and that progress is most rapid and effective through the free expansion of self-development.

It believes that science and invention must not be used to enslave men, but to free them from unnecessary work and so give them leisure and the chance of self-development.

It believes that men have "an inalienable right to life, liberty and the pursuit of happiness."

It believes that the system under which men live must represent truth and reality and not lies and falsity.

It believes that this system should develop a community of diversified and independent individuals and not a mass of standardised and servile ones.

It believes that this system should give not only security, but freedom, and that freedom, security and peace are one and indivisible.

It believes that every individual is a shareholder in the common heritage of Civilisation and that the wealth that flows from this heritage is part of his birth-right.

It believes that absolute economic security is the first and basic requirement of a New Civilisation in which every man will be entitled "to sit under his own vine and under his own figtree and none shall make him afraid".

Unless we believe in this philosophy of Social Credit it is useless to bother about anything else. If we do believe in it then we must advocate the principles and policies to make it effective.

Mr Young:

That is of academic interest, we feel, at the present time.

205. *How Social Credit Works,* page 92:

6. What is the JUST PRICE? The Just Price of an article is the price representing its true cost. It is determined by the ratio which total production of all descriptions bears to total consumption and depreciation. The Just Price is also called the COMPENSATED PRICE.

7. What is the JUST PRICE FORMULA? This is the mathematical formula used to determine the just price of an article in relation to its financial cost . . . The "Just Price" of any article is the cost of the goods actually CONSUMED in its production. "The Cost of production is Consumption."

Mr Young:

. . . that argument is useless . . . It is of academic interest.

NOTE 2 TO APPENDIX E

Computations of the Social Credit "Gap" Published in Social Credit Literature

(Reference paragraph 82 of Appendix E)

206. Three computations of the "Gap" published in Social Credit literature were discussed by the Commission with Mr Young, a witness for the New Zealand Social Credit Association, and with the Government Statistician, in some detail. These computations were:

(a) The gap between incomes received and national production in 1950–51, published in the *New Zealand Social Crediter,* 15 March 1955, pages 6 and 7.

(b) The statement of the gap for 1951–52 in *Social Credit's Solution* (pages not numbered), a pamphlet published by the New Zealand Social Credit Political League in 1954.

(c) *"Production and Income, 1950–51"*, appearing at pages 8 and 9 of *Social Credit is the Key,* by G. Hinton Knowles, in collaboration with F. D. Danks.

Results of the examination in respect of these three computations are summarised in the following paragraphs.

The gap between incomes received and national production, 1950–51, from the *New Zealand Social Crediter*

207. This compilation sets out to compare *"money incomes of New Zealanders obtained through the production of consumer goods and services"* in 1950–51 with *"the total retail prices of such consumer goods and services".*

208. The compilation as published was as follows:

VALUE OF PRODUCTION

		£
In the year ended 31/3/51 (see 1951–52 Year Book, page 961) ..		473,200,000
This figure represents value at point of production. Nothing added to cover costs of distribution. Services not included.		
DEDUCT EXPORTS (Calendar year 1950), (i.e. goods produced in N.Z. but not placed on N.Z. market)	£	
F.O.B. Value	183,700,000	
Less 25 per cent	45,900,000	
		137,800,000
		335,400,000

This deduction of 25 per cent is made to reduce F.O.B. value to value at point of production.

ADD IMPORTS (Calendar year 1950)	158,000,000
C.D.V. and 10 per cent added only.	
	493,400,000
ON COST	
At least 50 per cent must be added to cover distribution charges, etc.	246,700,000
Gross National Production at Retail Prices	£740,100,000

NOTE.—O.E.N.I. = Official Estimates of National Income.
I.I.T.S. = Income and Income Tax Statistics.

(Reports published by Census and Statistics Department, Wellington).

INCOME OF NEW ZEALANDERS

Available for purchase of National Production

(See Report on the Official Estimates of National Income, 1954)

	£
YEAR ENDED 31/3/1951	
O.E.N.I. Salaries and Wages	279,000,000
O.E.N.I. Armed Forces	6,000,000
O.E.N.I. S.S. Benefits and Pensions	48,000,000
O.E.N.I. Other Personal Income	193,000,000
I.I.T.S. Company Dividends	18,000,000
	544,000,000
O.E.N.I. and I.I.T.S. Less Direct Taxes (excluding direct taxes on Companies, as only dividends have been included above)	75,000,000
	£469,000,000

	£
Production Value (see above)	740,100,000
Private Net Income	469,000,000
Apparent "Gap"	£271,100,000

There are two major amendments to these figures which must be made before we can approximate the true "Gap". What portion of the Gross National Production is Capital Goods production and which theoretically does not make a demand on personal income? Of the total personal income computed for the year, what is the figure for transferred incomes? We have already made one deduction for transferred income – direct tax – but no deduction has been made of other transferred income, such as fees paid to doctors, etc.

Allowing the sum of £171,100,000 for the value of capital goods and £100,000,000 for transferred incomes, the estimated true "Gap" is as follows:

	£
Apparent Gap	271,100,000
Add transferred incomes (estimated)	100,000,000
	371,100,000
Deduct value of capital goods (estimated)	171,100,000
Estimated True Gap	£200,000,000

209. We would remark that direct compilation of incomes earned in production of consumer goods would be a most difficult, if not an impossible, statistical operation because it is the "end-use" that determines whether goods or services form part of capital goods or consumer goods. To take a simple example, timber may be used for repairs (consumer services) or for new construction (capital). How then are wages paid in the bush or in the timber mill to be apportioned? In the above table the compiler avoided this difficulty by including all salaries and wages and

other incomes, whether earned in production of capital goods or of consumer goods and services.

210. Notwithstanding inclusion of all such incomes, a subtraction of £171·1 million has been made from the figure for total production to obtain an estimated figure for the production of consumer goods and services, before comparing this with total incomes. This is, of course, a serious error. Mr Young agreed that if a deduction of this nature had been made on the production side without a corresponding deduction from incomes it *"would be quite a serious error of principle"*. The statement also omits Government and local authority expenditure on consumer goods.

211. No evidence was forthcoming to support the accuracy of the subtraction of 25 per cent as representing the reduction of the f.o.b. values of exports to the *"value at point of production"*. Nor was Mr Young able to substantiate the addition of 50 per cent as *"on cost"*. He agreed that the accuracy of the results of the table was dependent on the correctness of these percentages.

212. The Government Statistician said of this estimate that a statistician *"would have to disown it . . ."*. He also commented that the difference between the two sides of the statement was due to errors in compilation. Although the above table is admittedly an improvement on the other compilations discussed in this Appendix, we are satisfied from the evidence of Mr Young and of the Government Statistician that it is of no value as evidence of a gap between purchasing power and prices.

Computation of the gap for 1951–52 in *Social Credit's Solution*

213. This statement of the gap reads:

	£
Total price of all goods produced for sale in New Zealand ..	670,500,000
Total incomes earned by the people	477,000,000
Shortage of money or income	£193,500,000

214. From the evidence it appears to us that the above table was computed approximately as follows:

		£(million)
VALUE OF PRODUCTION 1951–52		426·3
DEDUCT EXPORTS (Calendar Year 1951):		
F.O.B.	248·1	
Less 25%	62·0	
		186·1
		240·2
ADD IMPORTS (Calendar Year 1951):		
C.D.V. + 10%		206·5
		446·7
ADD "On Cost" 50%		223·4
Value of Goods at Retail Prices		£670·1
INCOMES		
Salaries and wages for 1950–51		275·3
Company and other incomes for 1949–50		201·5
		£476·8

215. It appears that the total income of £476·8 million was computed by multiplying the social security charge receipts for 1950–51 – £35·766 million – by $13\frac{1}{3}$. Such receipts represent tax on salary and wages for 1950–51 and company and other incomes for 1949–50, at 1s. 6d. in the pound.

216. The computation of goods produced is subject to the same criticisms regarding the addition of arbitrary percentages as the table published in the *New Zealand Social Crediter* of March 1955. The remarkable thing about the statement published in *Social Credit's Solution* is that, as shown above, it compares an assessment of production for 1951–52 with salaries and wage incomes for 1950–51 plus company and other incomes for 1949–50. Such a comparison is quite worthless.

"Production and Income, 1950–51" in *Social Credit is the Key*

217. This computation of the gap for 1950–51 is as follows:

PRODUCTION AND INCOME, 1950–51

Does our financial system distribute sufficient purchasing power by way of wages, salaries, dividends and profits to pay the price of what is produced at any given period?

FIGURES FROM 1952 YEAR BOOK

		£
Total Production (page 961)		473,000,000
Material production only. Value at point of production. No amount added for transport or distribution through wholesaler or retailer. No valuation of services included.		
Deduct Exports (page 229)	£	
F.O.B. Value	184,000,000	
Less 25 per cent.	46,000,000	
		138,000,000
		335,000,000
This percentage deduction is necessary, as in all total production primary products are valued "on the hoof".		
Add Imports (page 251)		
C.D.V. and 10 per cent. only		158,000,000
		493,000,000
Add on Cost		
As nothing has been added to above figures for sales tax, excise or customs duties, transport, wholesale and retail distribution charges, then at least 40 per cent. must be added to find the cost to the consumer:		
40 per cent of £493,000,000 equals		197,000,000
Total Price Charges		690,000,000
Purchasing Power		
Wages, salaries, dividends, profits, other income, Social Security Tax gives a reasonably accurate figure for this item		477,000,000
Non-taxed income, including evasion (say)		23,000,000
		£500,000,000
Total Price Charges, as above		690,000,000
Nett Cash Income		500,000,000
		£190,000,000

It is obvious that £500,000,000 of income cannot liquidate £690,000,000 of price charges. There may be differences of opinion on the details given above and the percentages used, but it is submitted that there is clear proof in the above statement that costs are generated at a greater rate than incomes.

218. The above computation of production is similar to that published in *Social Credit's Solution* and is subject to similar limitations except that in this case *"on cost"* has been added at 40 per cent instead of 50 per cent. Again a mistake in income has been made by including wages and salaries for 1950–51 with company and other income for 1949–50 as total income for 1950–51. Mr Young admitted that this computation also was not competent statistical work.

219. Mr Young did not appear to have a competent understanding of these computations. He was under the impression that the gaps measured were before incomes received from public works or other supplements to income had been included. However, under cross-examination, he admitted that total incomes including incomes from public works had been included in the computations. Mr Young said, *"I would say as a practical observation round the country, for anyone to suggest there was a net gap of that sort, he was a dreamer"*.

220. In his evidence, the Government Statistician confirmed the erroneous nature of the three compilations referred to above. Furthermore, Mr Jordan disowned them and said, *"I should say truly that these statements have never been received as correct by the general body of social crediters, nor by the many who have always urged and have objected to these statements from time to time, on the ground that the compilers haven't the necessary information, and on the further ground that the state of full employment and the state of high prices under which our economy has existed during the past few years, have indicated that there could not be anything like the amount of gap that has been estimated"*.

221. We are satisfied that the statistical computations of the gap printed in publications of the New Zealand Social Credit Association and of the New Zealand Social Credit Political League are faulty statistical work having no value as evidence for or against the existence of a shortage of purchasing power and certainly providing no sound basis for any issues of debt-free money.

222. In answer to a request of the Commission the Government Statistician supplied the following statement setting out aggregate incomes and production over a period of years 1950–51 to 1954–55:

GOODS AND SERVICES COMPARED WITH INCOMES

(£million)

—	1950–51	1951–52	1952–53	1953–54	1954–55
Goods and Services					
1. Gross National Product at market prices	696	722	754	834	927
2. Less imputed rental value of owner occupied houses	−14	−15	−16	−19	−21
3. Export surplus (−) or deficit (+) ..	−30	+30	+5	−28	+39
4. Total goods and services available at market prices	652	737	743	787	945

GOODS AND SERVICES COMPARED WITH INCOMES—*continued*

(£million)

—	1950–51	1951–52	1952–53	1953–54	1954–55
Incomes					
5. Wages, salaries, interest, dividends and profits on which social security tax is paid:					
(a) Earned in current production of goods and services	580	589	621	689	755
(b) Interest paid to holders of the public debt domiciled in New Zealand	17	17	17	18	20
	597	606	638	707	775
6. From which Government has levied in taxation (including local authorities)	−113	−142	−146	−154	−168
7. Leaving in the hands of the public out of current incomes	484	464	492	553	607
8. But the Government has returned to the public tax free social security payments (including pensions) ..	48	54	54	58	61
9. In addition there are depreciation allowances on which no tax has been paid (therefore not included in (5) above)	39	43	46	50	57
10. Total incomes in the hands of the public to purchase goods and services ..	571	561	592	661	725
But the Government (General and Local Authority) spends the income it collects from the public. This amounts to:					
11. Direct taxation (deducted from private purchasing power (see (6) above) ..	113	142	146	154	168
12. Indirect taxation included in the prices of goods and services (4) above ..	56	71	67	68	82
Less subsidies on consumer goods ..	−9	−16	−15	−16	−13
Making	47	55	52	52	69
13. Profits from Government Departments trading and non-trading	16	19	18	24	27
14. Gross Government Income	176	216	216	230	264
15. The Government has returned to the public taxfree social security benefits (which it therefore cannot spend itself) (see (8) above)	−48	−54	−54	−58	−61
16. Interest on the public debt domiciled in New Zealand (included in (5) above) is also returned to the public so Government cannot spend it ..	−17	−17	−17	−18	−20
17. Net Government income from which it can purchase goods (e.g., materials for public works included in (4) above) and services (e.g., Civil servants' services included in (4) above)	111	145	145	154	183
18. Total incomes:					
In hands of – Public (10 above) ..	571	561	592	661	725
In hands of – Government (17 above)	111	145	145	154	183
Total Incomes	682	706	737	815	908

GOODS AND SERVICES COMPARED WITH INCOMES—*continued*

(£million)

—	1950–51	1951–52	1952–53	1953–54	1954–55
19. Decrease in overseas assets (+) or additions to overseas assets (−) ..	−30	+30	+5	−28	+39
20. Total (18 + 19)	652	736	742	787	947
21. Total value of goods and services available (4 above)	652	737	743	787	945
Rounding of figures causes these differences	..	−1	−1	..	+2

223. The above statement shows an equality between goods and services becoming available at market prices and total incomes (after allowing for changes in overseas assets). (See comment in paragraph 60 of this Appendix.) The Government statistician agreed that his tabulation was *"an effective statistical refutation of any contention that there has been a chronic shortage of purchasing power in the hands of the people relative to the price of total production in those years"*. He also said that if statements on the same basis were prepared for other years the results would be similar.

224. The Government Statistician's statement does not prove that purchasing power is always sufficient to make the best use of the country's resources without generating inflation. It does, however, prove that there is no chronic defect in the industrial and financial system which must lead to a shortage of purchasing power and which would therefore justify issues of new money as a regular feature of budgetary policy.

Appendix F

SUBMISSION OF Mr H. J. KELLIHER AND THE MIRROR PUBLISHING COMPANY LIMITED

TABLE OF CONTENTS

I. Introduction

1. Mr H. J. Kelliher, in association with The Mirror Publishing Company Limited, made lengthy submissions to the Commission through his witness, Mr W. S. Otto. Mr Kelliher himself did not appear at the hearings, but was represented by counsel, Dr O. C. Mazengarb, Q.C. These submissions, which were obviously the result of much careful thought and preparation, comprised six parts dealing with the following subjects:

(a) Existing banking and economic system.
(b) Overseas trade – wages – fiscal policy – criticism of present system.
(c) Recommendations for reform of existing banking system.
(d) Other recommendations for reform.
(e) Summary of proposals for reform.
(f) A recommendation that New Zealand should not join the International Monetary Fund.

2. The hearing of Mr Otto's evidence and his examination and the addresses of counsel occupied a period of nearly twelve days. Wherever we ascribe matter to Mr Kelliher in this report we are referring to the preliminary documents placed before the Commission, to the prepared submissions, and to the remarks of Mr Kelliher's counsel. Where Mr Otto is mentioned we refer to his statements under examination, to his written replies to questions put to him during the hearings, and to documents presented in amplification of his evidence.

3. In general, these submissions comprised an analysis of the existing economic system with special emphasis on the banking system, a statement of the weaknesses which Mr Kelliher regarded as inherent in the economic and banking systems, and suggestions for curing such weaknesses.

4. Mr Kelliher asserted that the following defects were inherent in the existing banking system:

(a) The lending and investment operations of the trading banks were expanded in times of prosperity in the ordinary course of their business, and contracted in less prosperous times.
(b) These operations resulted in the creation and destruction of money, that is, an expansion and contraction in the volume of money.
(c) This expansion and contraction of the volume of money was the major cause of the rise and fall in prices.

Mr Kelliher claimed that the Loanable Funds Scheme would remedy these defects and achieve stability in the volume of money, and that the Loanable Funds Scheme in conjunction with certain associated proposals would ensure substantial stability in prices.

Volume of Money

5. In the course of his submissions Mr Kelliher gave a number of examples of the operation of the Loanable Funds Scheme, from which it is apparent that he attached the greatest importance to the maintenance of a constant or stable volume of money.

6. The volume of money, as defined by the Reserve Bank of New Zealand and accepted and used by Mr Kelliher in his analysis of the existing banking system, comprises the following:

(a) Coin in circulation.
(b) Notes in circulation.
(c) Credit balances of customers in their current accounts at trading banks (demand deposits).
(d) Credit balances of Government and marketing accounts at the Reserve Bank.

7. The volume of money, and especially the volume of demand deposits held by the public at the trading banks, is affected from time to time by certain banking transactions, e.g., an increase in total trading-bank advances may, but does not always, result in an increase in demand deposits and, consequently, in the volume of money. On the other hand, a net reduction in bank advances originating from free deposits would reduce the volume of money. A purchase of investments by a trading bank may also result in an increase in demand deposits and, consequently, in the volume of money. The sale of investments by a trading bank may be expected to have the reverse effect. The effect of transactions such as the above on the volume of money is illustrated hereunder:

		Volume of Money (£million)
Suppose the volume of money is		312·6
Increase in trading-bank advances of £10 million might cause customers' demand deposits to rise by	(+)	10·0
A net reduction in trading-bank advances of £5 million might reduce demand deposits by ..	(–)	5·0
The purchase by trading banks of investments costing £3 million might increase demand deposits by ..	(+)	3·0
The sale of investments for £2 million might reduce demand deposits by	(–)	2·0
Volume of money after above transactions ..		£318·6

8. All increases in advances do not necessarily cause corresponding increases in deposits. An advance on overdraft by an individual bank may result in a corresponding reduction in advances made by the same or by another bank; in that case, the volume of money as defined by the Reserve Bank would not be affected. Similarly, an advance used by a customer to purchase overseas exchange would not affect the total of free deposits and, consequently, would not affect the volume of money.

Creation of Credit

9. Terms such as "creation of money" or "creation of credit", as applied to trading-bank transactions, are misleading if they give the impression that the trading banks can create unlimited credit. This is far from true. The witnesses for the banks agreed that the trading banks do create money in the course of their lending operations. We believe that it is more nearly correct to say that the creation of new and additional money may, and in fact often does, occur as a consequence of lending by the banks rather than to say, as Mr Kelliher did, that the banks *"create the money they lend"*. When a trading bank makes

advances it may well lose an equivalent, or nearly equivalent, sum in bankers' cash or in overseas funds, and it must conduct its business within these limits. In addition, the lending operations of trading banks are subject to control by the Reserve Bank which, by the operation of the reserve ratio system, freezes a proportion of the balances held by the trading banks at the Reserve Bank. The extent of credit creation by the trading banks, therefore, is subject to important limitations and safeguards.

Views of Economists on Changes in the Volume of Money

10. As mentioned previously, Mr Kelliher, in his submissions, attached the greatest importance to changes in the volume of money as causes of price movements. This view is not generally accepted by economic authorities. Geoffrey Crowther, in his book *An Outline of Money,* page 124, says, *"The modern tendency in economic thinking, indeed, is to discard the old notion of the quantity of money as a causative factor in the state of business and a determinant of the value of money and to regard it as a consequence".* Paul A. Samuelson, in his book *Economics – An Introductory Analysis,* page 293, takes a similar view to Crowther's in the following passage: *"The fact, however, that the quantity theory is a simplification of the truth and does not always hold with great precision should not be used to damn it utterly. If at least it indicates the general direction of economic behaviour, that would be a great deal to be said in its favour. Unfortunately, even this limited claim cannot always be made for the quantity theory".* It is apparent from these quotations that these two recognised economists ascribe only a limited importance to changes in the volume of money as causes of price movements. Similar views are expressed in the *Economic Journal* of March 1955 by Messrs E. H. Phelps Brown and S. A. Ozga after a study of long-term price trends in the United Kingdom.

11. Recent statistics show that between 1946 and 1954 the money supply in the United Kingdom rose by some 15 per cent. Over the same period the index of retail prices rose by over 50 per cent. This seems to indicate a probability that, in the main, the price increases in the United Kingdom arose from causes other than the moderate increase in the money supply.

12. Under Mr Kelliher's scheme, he claimed that the volume of money would remain constant unless some independent action was taken by the State to increase or reduce it. He considered that such increases or reductions should result only from deliberate actions by the State.

Velocity of Circulation

13. Mr Kelliher was at some pains to show that, in his view, velocity of circulation of money was of only minor importance in any assessment of the causes of inflation. He recognised that the greater use of existing money (i.e., an increase in velocity of circulation) might in certain circumstances (e.g., increasing import prices) avoid the need for increasing the money supply. In discussing velocity of circulation, however, Mr Kelliher omits to take into account the possibility that the operations of the Loanable Funds Scheme, by transferring dormant funds to savings deposits and making increased advances on the basis of

additional savings deposits so acquired, might stimulate considerably the velocity of circulation of the remaining demand deposits. Any such stimulation could have a similar immediate effect on spending, and on the price level, to an increase in the money supply. According to the Reserve Bank computation, the index of the velocity of circulation of money fell from 100 in 1939 to 50 in 1945, and has since risen to 70. If the velocity of circulation were to increase again to anything like the pre-war level of 100, there is no doubt that the effect would be considerable.

Legality of Credit Creation

14. Mr Kelliher disputed the legal right of New Zealand trading banks to operate as they do. Mr Otto admitted, under examination, that even under the Loanable Funds Scheme the banks would create and destroy money according to the accepted definition of money supply. It would appear, therefore, that the accusations of illegality made by Mr Kelliher would apply with similar force to the operations of trading banks if conducted under the Loanable Funds Scheme. The legal position regarding creation of money by trading banks is discussed in paragraphs 432 to 433, and 541 of our report and in Appendix D.

Moral Issues

15. Mr Kelliher raised the question *"whether the banks have any legal or moral right to create the original issue of money and to expand the money supply"*, and sought a recommendation from the Commission, in respect of creation of money by trading banks, *"that there is no legal or moral right to do what they have been doing, and it ought to be stopped"*. The Commission would scarcely wish to set itself up as a judge of morals. The trading banks could no doubt be held morally culpable if the lending operations complained of were either deliberately injurious to the public interest or if they had been conducted selfishly or regardless of the public interest. There is no evidence before the Commission to suggest that the trading banks have acted in such a way.

16. The allegation of moral wrong seems to be based on the assumption that all blame or a very large part of any blame for price increases should be ascribed to the lending operations of trading banks. In our view, for reasons explained elsewhere, this assumption is not well founded.

II. Full Reserve or 100 Per Cent Money

Influence of "100 Per Cent Money" on the Kelliher Proposals

17. Before outlining the mechanism of the Loanable Funds Account, Mr Kelliher gave a summary of the principles of "Full Reserve or 100 per cent Money", from which it became apparent that those principles had exerted a strong influence in the development of the Loanable Funds Scheme. Proposals similar to those of full reserve money were also submitted to the Commission by Mr A. N. Field. Full reserve or 100 per cent money was first advanced during the years 1930 to 1935 by Professor Irving Fisher and a group of economists at Chicago, U.S.A. In essence, this scheme involved bringing the balances of the trading

banks at the Central Bank, plus notes and coin held by the trading banks, up to the equivalent of 100 per cent of customers' demand deposits at the trading banks; thereafter, this 100 per cent ratio was to be maintained. The general effect of the scheme was to limit future trading-bank lending to the equivalent of repayments of overdrafts, sales of investments or other assets, plus increases in time deposits with the trading banks and any borrowing from the Central Bank.

18. Professor A. G. Hart, in *The Review of Economic Studies,* Volume II, page 104, described the original main objectives of 100 per cent money as:

(a) Removal of risk to customers' deposits.
(b) Repayment of United States public debt held by the trading banks.
(c) Control of inflation and deflation.

Professor Hart noted in 1935 that, in the United States, (a) and (b) were of historical interest only.

19. Apart from a temporary and partial experiment in Mexico, which apparently was abandoned because the 100 per cent requirement for additional deposits proved to be too rigid, it appears that the 100 per cent money scheme has not been adopted anywhere. Mr Colin Clark mentioned 100 per cent money in his evidence before the Commission, but he did not recommend it for New Zealand or for any sterling area country. Mr Clark considered that control over trading-bank advances, as far as the system could give it, could be exercised under the existing ratio system, and he also agreed that any increase of advances which did occur under the 100 per cent money scheme would have the effect of increasing the money supply in the hands of the public.

20. Part III of Mr Kelliher's submissions contained the following quotation from Benjamin Higgins' *Comments on 100 Per Cent Money (1931): "the degree of effectiveness of the plan in preventing over-investment depends upon the extent to which time deposits can be identified with savings and demand deposits with money".* This statement is fundamental to the argument for 100 per cent money. Its application to the banking system of New Zealand today is of doubtful validity, because the evidence shows that the large amounts of dormant money included in the free deposits of the banks are really savings. The mere segregation of them from the remaining free deposits as proposed under the Loanable Funds Scheme would not change their character. Under the Loanable Funds Scheme the trading banks would be in a position to compete not merely for current savings, but also for past savings, including those held in the Post Office Savings Bank and other savings institutions. Notwithstanding these facts, under the 100 per cent money scheme, and under the Loanable Funds Scheme, any demand deposits which were transferred to time deposits would automatically entitle the trading banks to make additional advances of an equivalent sum.

21. According to the demonstration of 100 per cent money given by Mr Kelliher, it would have been necessary for the Reserve Bank to lend to the trading banks £142·7 million as at 30 June 1954, in order to bring their balances at the Reserve Bank, plus coins and notes, up to 100 per cent of demand deposits. Mr Kelliher preferred to submit his own variation of 100 per cent money, the Loanable Funds Scheme.

III. The Loanable Funds Scheme

22. Under the Loanable Funds Scheme the permissible limit to increases in trading-bank advances (or investments) at any time is determined by the balance remaining in a "Loanable Funds Account" appearing on the assets side of the bank balance sheet. On the liabilities side of the balance sheet there appears an account called by Mr Kelliher "Bank Demand Deposits". These two accounts have been specially devised for purposes of the Loanable Funds Scheme and are in addition to and apart from the normal processes of bank book-keeping. The Loanable Funds procedure ensures that any increase in the "Loanable Funds Account", such as a reduction in total advances to customers, is reflected in a corresponding increase in the account called "Bank Demand Deposits" and likewise any decrease in the Loanable Funds Account, as would arise from an increase in total advances to customers, would similarly decrease "Bank Demand Deposits".

The "Loanable Funds Account"

23. As mentioned above, under the Loanable Funds Scheme, future trading-bank lending and investment transactions are to be limited by the balance available from time to time in the Loanable Funds Account. Such balance will be increased by:

(a) Existing and future loans repaid to the banks.
(b) Amounts which the banks borrow from their customers on fixed deposits or from other sources.
(c) The sale of overseas exchange to importers and travellers.
(d) The sale of securities or other investments held by the banks.
(e) The profit which the banks make from interest, discount, exchange, etc.
(f) Any additional amount which shareholders or others may subscribe for further share capital, in the same way as other companies obtain further share capital for their businesses.
(g) Any advances which the Reserve Bank may be prepared to make to a trading bank under section 13 of the Reserve Bank Act.

24. On the other hand, the balance in the Loanable Funds Account will be reduced by:

(a) Advances by overdraft or other loans.
(b) Discounting of export bills.
(c) The purchase of investments, securities, buildings, or other assets.
(d) Payments to visitors from overseas in return for overseas money.
(e) The payment of administration and other expenses and dividends to shareholders.

25. The Loanable Funds Scheme would commence on the basis of the level of trading-bank advances in existence at the inception of the scheme. Any repayments of existing advances would be available for relending to bank customers. The scheme would, therefore, not reduce trading-bank advances below the total outstanding at the commencement of the scheme.

26. The Loanable Funds Account would operate in this way. The totals of the transactions are to be recorded in the Loanable Funds Account by a series of entries additional to the normal process of bank book-keeping. As the asset account "Loanable Funds" is increased or

reduced, a *contra* account on the liabilities side of the bank balance sheet, called by Mr Kelliher "Bank Demand Deposits", is similarly increased or reduced. The entries are so arranged that the balance of one account will always be the *contra* of the other, and therefore the balances would always be equal in amount. For example, repayment to a trading bank of an advance of £1,000 would increase by that amount both Bank Demand Deposits Account and Loanable Funds Account and so make the repayment of £1,000 available for relending. Similarly, an increase in advances of £2,000 would reduce the balances of the two *contra* accounts and so reduce the unexercised lending margin of the bank. These *contra* entries and accounts are merely a method of computing and recording the unused lending potential for the time being of the trading banks under the Kelliher scheme. The Loanable Funds entries make no difference to the effects on the economy of bank lending or borrowing transactions.

27. It is intended by Mr Kelliher that a Loanable Funds Account and a Bank Demand Deposits Account should be kept in the books of each branch of each trading bank. The Associated Banks commented on this as follows: *"The balances would be at best useless, and at worst completely misleading, as information to the branch managers. Some areas are traditional sources, and other areas users of funds. No particular branch balance would have any meaning, except as part of the overall total, on which Head Office policy would be based"*. We agree that the balances of these accounts at a particular branch would not necessarily be of any value in determining the appropriate limit of total advances for that branch.

Demonstration of Credit Creation

28. As already noted, the demonstration that trading banks may create and destroy money, or expand and contract the volume of money or the money supply by their lending and investment transactions, was based on the Reserve Bank definition of money supply applied to some thirty-two hypothetical examples, of which transactions one to twelve increase the money supply, thirteen to twenty reduce it, and twenty-one to thirty-two neither increase nor decrease it.

Change of Definition of "Money Supply"

29. Mr Kelliher recognised in principle that it was necessary to adopt a consistent terminology with precise meanings when speaking of bank transactions and of the money supply. He claimed, indeed, that throughout his demonstrations the definitions adopted by the Reserve Bank were accepted and used. Mr Kelliher adhered to the Reserve Bank definition of money supply in Part I of his submissions where he demonstrated that certain trading-bank transactions under existing banking techniques led to increases and decreases in the money supply, or, in other words, to the creation and destruction of money. When he demonstrated the working of the Loanable Funds Scheme, however, he departed from the Reserve Bank definition of the money supply and, in effect, changed not only the meaning of the term "money supply", but also the content of the statistical table, the total of which constitutes the money supply at any time.

Apparent Constancy of Money Supply Under Loanable Funds Scheme

30. By so changing the definition or content of the money supply, Mr Kelliher achieved an apparent constancy in the money supply, demonstrated in Part III of his submission, where he purported to show that certain transactions which increase or decrease the money supply under the present banking technique did not do so under the Loanable Funds Scheme.

31. Using the Reserve Bank definition of money supply, a specimen transaction in Part I of Mr Kelliher's submissions, showed that increased advances of £10 million may result in increased demand deposits at the trading banks of the same amount. Since the transaction did not reduce or otherwise affect any other part of the money supply, such as coin, notes in circulation, or demand liabilities of the State at the Reserve Bank, Mr Kelliher concluded correctly that there could be a corresponding increase of £10 million in money supply as defined by the Reserve Bank.

32. In Part III of the submissions, however, where the same transaction was dealt with in accordance with the Loanable Funds procedure, there was the same increase of £10 million in demand deposits held by the public, and again no alteration in the other items included by the Reserve Bank in its computation of the money supply. In this case there was no apparent increase in total money supply because, in order to preserve a constant total, Mr Kelliher introduced into the money supply table the fictitious item which he called "Bank Demand Deposits" and which is not properly part of the money supply because it is not available for spending by bank customers.

Results of Change in Definition of Money Supply

33. The effects of the same specimen transaction on the money supply, with and without this change in definition or in the composition of the money supply, are shown below:

—	Reserve Bank Definition Illustrated in Part I			Loanable Funds Definition Illustrated in Part III		
	Money Supply Before Transaction	Change Resulting From Transaction	Money Supply After Transaction	Money Supply Before Transaction	Change Resulting From Transaction	Money Supply After Transaction
	£ million	£ million	£ million	£ million	£ million	£ million
(a) Coin, notes, and demand deposits at Reserve Bank	71·7	..	71·7	71·7	..	71·7
(b) "Public demand" or "free" deposits	208·9	+10	218·9	208·9	+10	218·9
(c) "Bank demand deposits" ..	..	..	..	32·0	−10	22·0
(d) Total "money supply"	280·6	+10	290·6	312·6	Nil	312·6

34. A careful study of the above table reveals the following:

(a) *Coin, notes, and demand deposits at the Reserve Bank of New Zealand.*—There is no change in this item, which remains at £71·7 million in both instances.

(b) *Public Demand or Free Deposits.*—There is an increase of £10 million from £208·9 million to £218·9 million in this item in both cases. Up to this point, therefore, the effect of the transaction is identical in both cases.

(c) *"Bank Demand Deposits".*—It will be noted that, in the Loanable Funds examples, the increase in free deposits of £10 million is offset by a reduction of an equivalent amount in Bank Demand Deposits from £32 million to £22 million. Thus the real increase in the money supply which has occurred in both cases is obscured in the Loanable Funds example by introducing into the Loanable Funds computation of the money supply the fictitious item Bank Demand Deposits.

35. The details of the transactions used by Mr Kelliher in his demonstration to the Commission are shown in the table facing this page. It will be seen that in all these examples it is only by the introduction of the same fictitious item Bank Demand Deposits that he has maintained an apparently constant total of the money supply.

Loanable Funds Accounts at Other Branches of Trading Banks

36. In a special note Mr Otto suggested that Loanable Funds Accounts could be kept for each trading-bank branch at some branch of another trading bank. This variation, to which Mr Otto saw practical objections, would not justify the inclusion of Bank Demand Deposits in the Reserve Bank definition of money supply because paragraph (c) of the Reserve Bank definition, as set out by Mr Otto himself, includes these words *"free deposits held by customers in their bank accounts"*. Even if each trading-bank branch kept a Loanable Funds Account at some branch of another trading bank, the money could not be spent by bank customers and would not be purchasing power available to bank customers. **Thus the attempts to justify the inclusion of Bank Demand Deposits in the Reserve Bank definition of the money supply fail completely, not merely in logic but also in fact because, as mentioned above, Bank Demand Deposits, however they are recorded in the banks' books, are not money belonging to bank customers and therefore cannot be spent by them.**

37. The importance of definition upon the results of matters in argument can be gauged from Will Durant's *The Story of Philosophy*, page 59, where he says, *"How many a debate would have been deflated into a paragraph if the disputants had dared to define their terms! This is the alpha and omega of logic, the heart and soul of it, that every important term in serious discourse shall be subjected to the strictest scrutiny and definition. It is difficult, and ruthlessly tests the mind; but once done it is half of any task."* Again, in his book *Straight and Crooked Thinking*, Robert H. Thouless says, on page 192, *"The most obvious piece of crooked thinking which results from an absence of clear meanings is that in which a word is used in different senses in different parts of the same argument"*. This is precisely what Mr Kelliher has done, where repeatedly throughout his submissions he gives to the term "money supply" one meaning where he demonstrates that trading banks create and destroy money under the existing system, and a different and, in our view, a fallacious meaning, when he purports to demonstrate that under the Loanable Funds Scheme the trading banks would not create and destroy money.

TABLE TO APPENDIX F (reference paragraph 35 of Appendix).

Summary of Loanable Funds Transactions 1 to 11 Submitted by Mr Kelliher to Demonstrate the Working of the Loanable Funds Scheme Showing the Entries by Which an Apparent Constancy of Money Supply is Achieved

(£ million)

Transaction No.		Details and Amount of Transaction	Trading Bank Liabilities						Trading Bank Assets								Loanable Funds Contra Entries	Money Supply			
			Total Liabilities	Capital and Reserves	Savings Deposits	Public Demand Deposits	Bank Demand Deposits*		Loanable Funds		Net Overseas Assets	Advances and Discounts	Investments	Land and Buildings	Coin, Notes, and Reserve Bank Balances	Total Assets		Including Bank Demand Deposits and Departing from Accepted Definition of Money Supply		Using Accepted Definition of Money Supply, i.e., Excluding "Bank Demand Deposits"	
Pt. I	Pt. III						Movements	Balance	Movements	Balance								Effect of Transaction	Total After Transaction	Effect of Transaction	Total After Transaction
			299·3	7·6	50·8	240·9					21·3	149·4	26·0	4·4	98·2	299·3	Dr. Cr.				
13	1	Repayment of advances .. 5	..	..	..	− 5	+ 5*	5*	+ 5	5	..	− 5	..	..	..	..	Loanable Funds .. Dr. 5 To Bank Demand Deposits .. 5	− 5 + 5*	.. 312·6	.. − 5	312·6 307·6
14 and 29	2	Increase in savings deposits .. 5	..	..	+ 5	− 5	+ 5*	10*	+ 5	10	..	..	..	..	..	..	Loanable Funds .. Dr. 5 To Bank Demand Deposits .. 5	− 5 + 5*	.. 312·6	.. − 5	.. 302·6
15	3	Sale of exchange to importers .. 15	..	..	..	−15	+15*	25*	+15	25	−15	..	..	..	..	..	Loanable Funds .. Dr. 15 To Bank Demand Deposits .. 15	−15 +15*	.. 312·6	.. −15	.. 287·6
16	4	Sale of investments by trading banks 2	..	..	..	− 2	+ 2*	27*	+ 2	27	..	..	− 2	..	..	..	Loanable Funds .. Dr. 2 To Bank Demand Deposits .. 2	− 2 + 2*	.. 312·6	.. − 2	.. 285·6
..	5	Increase in trading bank capital .. 5	..	+ 5	..	− 5	+ 5*	32*	+ 5	32	..	..	..	..	..	..	Loanable Funds .. Dr. 5 To Bank Demand Deposits .. 5	− 5 + 5*	.. 312·6	.. − 5	.. 280·6
1	6	Increase in trading bank advances 10	..	..	..	+10	−10*	22*	−10	22	..	+10	..	..	..	..	Bank Demand Deposits .. .. Dr. 10 To Loanable Funds 10	+10 −10*	312·6	+10	290·6
2	7	Increase in trading bank investments 3	..	..	..	+ 3	− 3*	19*	− 3	19	..	..	+ 3	..	..	..	Bank Demand Deposits .. .. Dr. 3 To Loanable Funds 3	+ 3 − 3*	312·6	+ 3	293·6
3	8	Payment to finance exports .. 10	..	..	..	+10	−10*	9*	−10	9	+10	..	..	..	..	..	Bank Demand Deposits .. .. Dr. 10 To Loanable Funds 10	+10 −10*	312·6	+10	303·6
5	9	Capital transfer to New Zealand .. 2	..	..	..	+ 2	− 2*	7*	− 2	7	+ 2	..	..	..	..	..	Bank Demand Deposits .. .. Dr. 2 To Loanable Funds 2	+ 2 − 2*	312·6	+ 2	305·6
6	10	Purchase of bank building .. 1	..	..	..	+ 1	− 1*	6*	− 1	6	..	..	..	+ 1	..	..	Bank Demand Deposits .. .. Dr. 1 To Loanable Funds 1	+ 1 − 1*	312·6	+ 1	306·6
8	11	Repayment of savings deposits (wool retention) 4	..	..	− 4	+ 4	− 4*	2*	− 4	2	..	..	..	..	..	..	Bank Demand Deposits .. .. Dr. 4 To Loanable Funds 4	+ 4 − 4*	312·6	+ 4	310·6
Final balances			305·3	12·6	51·8	238·9	..	2·0	..	2·0	18·3	154·4	27·0	5·4	98·2	305·3					

*It is the inclusion of these fictitious items "Bank Demand Deposits" and contra entries marked * which enables the appearance of a constant money supply to be maintained throughout this series of Loanable Funds transactions. If the Reserve Bank definition of money supply is adhered to, the money supply would increase and decrease throughout these transactions as shown in the two columns on the extreme right of the table.

38. This point of definition is no mere formality but is of the greatest practical importance, because what is being measured in the Reserve Bank computation of money supply is spending power immediately available to the public or to the Government. It is through changes in money supply available to the public or to the Government that any inflationary or deflationary effects of expansion or contraction of bank credit work. If the public has more money to spend in the form of increased demand deposits at the trading banks, any measure of the money supply which does not reflect the increase is worthless and indeed misleading.

39. From the answers given by Mr Otto to the following questions it is clear that under the Loanable Funds Scheme a constant money supply is not achieved if the Reserve Bank definition of money supply is adhered to:

Question:

Do transactions 1 to 5 reduce public demand deposits from £240·9 million (see page 33 of Part III) to £208·9 million (see page 46 of Part III) . . . Do these transactions reduce the public demand deposits by £32 million?

Answer:

Yes.

Question:

In terms of the Reserve Bank definition does the combined result of entries 1 to 5 represent a reduction in the money supply of £32 million?

Answer:

Within the Reserve Bank definition – yes.

Also Mr Otto admitted that, in terms of the Reserve Bank definition, Loanable Funds transactions 6 to 11 *"represent an increase in the money supply or the creation of money by £30 million"*.

40. Transactions 1 to 5 and 6 to 11 referred to above are the complete set of transactions submitted by Mr Kelliher in Part III of his submissions to illustrate the working of his Loanable Funds Scheme.

41. The claim by Mr Kelliher that the Loanable Funds Scheme eliminates the alleged fundamental defect of creating and destroying money through trading-bank lending and investment transactions therefore fails completely.

Further Claims for Loanable Funds Scheme

42. In addition to claiming that the Loanable Funds Scheme would remove what he called the fundamental defect in the existing banking procedure, Mr Kelliher made a number of other claims for the Loanable Funds Scheme which are discussed in the next few paragraphs.

Overseas Transactions Under the Loanable Funds Scheme

43. Mr Kelliher said that overseas transactions would neither increase nor decrease the money supply. However, the overseas transactions demonstrated (i.e., Loanable Funds transactions 3 and 8) caused part of the increases and decreases mentioned in paragraph 39 above. Mr Otto admitted these increases and decreases in the money supply provided that a consistent definition of money supply is adhered to.

Bank Advances in Times of Recession

44. Mr Kelliher claimed that under the Loanable Funds Scheme any calling up of bank loans during a recession would not destroy the nation's money supply. However, under cross-examination, Mr Otto admitted that a reduction of advances under the Loanable Funds Scheme could reduce demand deposits held by the public, and he also admitted that such a reduction would be destruction of money in terms of the Reserve Bank definition. Under the Loanable Funds Scheme the amount of money available for spending by the public would be reduced if there was a restriction of trading-bank advances. Any claim that the calling up of bank loans would produce less serious effects in a recession under the Loanable Funds Scheme than under the present system therefore fails.

"Borrowing to Lend" (refer main report – paras. 531 to 540)

45. Mr Kelliher contended that, under the Loanable Funds Scheme, the trading banks would *"borrow to lend"*, whereas he declared that at the present time they did not do so. Mr Otto admitted that under the Loanable Funds Scheme an advance might create a demand deposit. He also agreed that a demand deposit was a debt by the bank to the customer and was, in that sense, borrowed from the customer. The process of lending and borrowing under the Loanable Funds Scheme may be described as follows:

(a) An advance may create demand deposits.
(b) The trading bank may borrow the money so created – repayable on demand.
(c) By a change in the term of borrowing, i.e., from demand to, say, three months, the bank may acquire authority to lend further money.
(d) Such further lending may create more demand deposits which –
(e) The trading bank may borrow, repayable on demand, and –
(f) To the extent that customers agree that the term of borrowing may be changed to, say, three months, the bank acquires further authority to lend, and so the process could go on.

Indeed, according to Mr Otto, the above process could continue as long as the banks wanted to lend and as long as they could borrow from somebody. Thus it appears that, under the Loanable Funds Scheme, the trading banks would receive on fixed deposit some of the deposits which had originally been created as demand deposits through the process of bank lending.

46. When setting out to prove that the trading banks do not at present *"borrow to lend"*, Mr Kelliher made use of an example in which trading-bank advances were increased by £10 million and at the same time there was an increase of the same amount in demand deposits held by the public. He correctly pointed out that, in such an example, the trading banks have not used *"any part of their customers' demand deposits which were left completely untouched, nor do they use any part of their time deposits, which were also left completely untouched"*. On the strength of this demonstration Mr Kelliher concluded that the trading banks did not borrow to lend but created new money through increasing their

interest earning assets, i.e., their advances. Under cross-examination in respect of the demonstration of a similar transaction under the Loanable Funds technique, Mr Otto gave the following answers:

Question:

Were any public demand deposits used in Loanable Funds Transaction No. 6?

Answer:

No.

Question:

Were any time or savings deposits used in Loanable Funds Transaction No. 6?

Answer:

No.

47. The above answers show that, under the Loanable Funds Scheme also, the trading banks would not use any of the money borrowed from their customers, in increasing advances by £10 million. **Mr Kelliher has therefore completely failed to establish that any new principle of "*borrowing to lend*" is introduced by the Loanable Funds Scheme, but the effects on the money supply of bank lending are complicated and obscured by the special items Mr Kelliher has introduced.** The "Loanable Funds Account" and its counterpart "Bank Demand Deposits" merely record the extent of the banks' authority to lend under the Kelliher scheme at any time.

48. The Loanable Funds Scheme does no more than place a variable upper limit on trading-bank lending and this could be achieved under the existing system. There is no device in the Loanable Funds Scheme to prevent a reduction in bank lending if the banks decide to reduce their lending, or if there is a scarcity of borrowers. Such a development, if on a serious scale, would require action by the Government, possibly through purchases of securities by the Reserve Bank or by Reserve Bank lending to the Government or to the trading banks. Mr Kelliher also contemplated the sale of securities by the Reserve Bank in certain circumstances if trading-bank advances rise too high. Therefore, under the Loanable Funds Scheme, there is no effective automatic limit to trading-bank advances; neither is there any reason why trading-bank advances or the volume of money should be at the level most appropriate in the circumstances prevailing from time to time. As under the present system, some authority would require to exercise judgment as to the timing and nature of the intervention by the Reserve Bank.

49. A vital feature of the Loanable Funds Scheme is the fact that the extent to which the trading banks would be able to expand their lending operations would depend in the main on their ability to attract additional savings or fixed deposits.

50. Difficulty in achieving this could so circumscribe their operations that they would be unable to fulfil the traditional functions of the trading banks. Under examination Mr Otto conceded that the Loanable Funds Account would lack the flexibility of the existing banking system.

51. Despite this admission of lack of flexibility, Mr Kelliher stated in the pamphlet *Why your £ Buys Less and Less: "I advocate a more elastic and vastly improved banking technique whereby trading banks would be enabled to lend from the existing stockpile of money to the limit of credit-worthy borrowing . . ."*. In our opinion, expansion of bank lending *"to the limit of credit-worthy borrowing"* in recent years would have meant

that trading-bank advances would have been substantially higher than they are under the existing system. We can see nothing in the Loanable Funds Scheme itself which would offset the inflationary effects on the economy of such an expansion of trading-bank lending. Mr Kelliher suggested that increased lending under the Loanable Funds Scheme might be offset by open market operations by the Reserve Bank. We are very doubtful whether this would be effective because large-scale sales would upset the limited market for Government stock in New Zealand. In our view, expansion of trading-bank lending to the limit of credit worthiness of customers desiring to borrow would be highly undesirable under buoyant business conditions such as have existed in recent years.

Effects on Balance of Payments

52. It was submitted that the Loanable Funds Scheme would *"establish a mechanism which in itself would at all times contain forces working towards equilibrium in balance of payments"*. There are, however, certain features of the scheme which might well have the opposite effect. Mr Otto admitted that there was no special control in the Loanable Funds Scheme to prevent a spiral of advances arising from repeated transfers of demand deposits to savings deposits. He suggested open market operations by the Central Bank in the event of *"a dishoarding movement from past savings"*. We are doubtful whether the sale of securities in the open market on a scale sufficient to be a corrective would be possible in New Zealand without seriously upsetting the market. Such a spiral could increase the demand for imports and therefore accentuate any tendency to a balance of payments deficit. It was also admitted that running down their holdings of overseas funds would increase the Loanable Funds of the trading banks and thereby increase their lending ability and consequently their profits if lending was expanded. This part of the scheme, therefore, might accentuate disequilibrium in balance of payments.

53. It is appreciated, of course, that under the Loanable Funds Scheme the trading banks would be required to work within current receipts of overseas funds. Nevertheless it does appear that the two features mentioned in the previous paragraph would tend to make it more difficult for them to do so. The trading banks would either have to pay special regard to their balances of overseas funds and operate virtually on a sterling exchange standard by restricting advances to the extent necessary to curb the demand for overseas exchange, or else lend as freely as loanable funds would permit and take other steps to ration the available overseas exchange.

Loanable Funds Scheme as a Means of Controlling Bank Advances

54. There are important defects in the Loanable Funds Scheme as a means of limiting bank advances. The danger of a substantial expansion of advances, which would be possible if there was a free flow from demand deposits to savings deposits, has already been referred to. Mr Otto admitted that the increase of £39·7 million in bank advances, which took place in the year ended 31 March 1955, could have occurred under the Loanable Funds Scheme if there had been a shift of £40 million from free to fixed deposits. It appears possible, but not likely, that a very substantial increase in bank advances might take place on the institution

of the Loanable Funds Scheme through a transfer from demand to savings deposits especially if, as is proposed by Mr Kelliher, the trading banks were free to increase interest rates on deposits.

55. The evidence given by both Mr Whyte and Mr Fussell showed that there was a substantial amount of dormant or inactive money included in the free deposits at the trading banks. Tests conducted by the trading banks revealed that there was an amount of from £60 million to £85 million which had lain dormant for a period of at least a year. This was interpreted by the banks' witnesses to mean that the holders of these deposits preferred to keep them in a form which made them immediately available if required, rather than invest them. This view is strengthened by the fact that these depositors have available to them the opportunity of placing their moneys on fixed deposit with the banks for various periods of time, or, for that matter, of investment in a variety of securities.

56. It is apparent from the evidence that, in the main, the holders of these deposits will not be induced to move them from free to fixed or savings deposits by current rates of interest. In his evidence, Mr Otto said that the banks might need to offer a rate of interest as high as 4 per cent in order to obtain a substantial movement from free to fixed deposits. Mr Fussell thought the rate would need to be about 7 per cent to effect a shift of the order of £60 million to £85 million.

57. As the Kelliher proposals included the freeing of interest rates from control, it would appear that Mr Kelliher recognises that the rates of interest charged by the trading banks for advances would have to be increased substantially. Under his proposals the profits of the trading banks would arise chiefly from the excess of their lending rates over those paid for savings deposits.

58. Under the existing system the trading banks are able to conduct their lending operations without the need to effect any substantial movements from free to fixed deposits, whilst still deriving the advantages for this purpose which the dormant deposits provide. If, under the Loanable Funds Scheme, the banks were unable to induce a transfer from free to savings deposits of a considerable order, they would be unable to meet the needs of an expanding economy by increasing advances, or to meet emergencies which may arise from time to time, such as financing exporters (when stocks of primary products were accumulating) or merchants (when heavy shipments of imports may arrive in the country following a shipping strike).

59. Mr Otto admitted that, in circumstances similar to those mentioned above, the trading banks might have to seek the assistance of the Reserve Bank. Mr Whyte's evidence revealed a strong antipathy on the part of the trading banks to seeking the support of the Reserve Bank, no doubt arising from a traditional confidence in their ability to manage their own affairs.

60. It is obvious that Mr Kelliher's scheme would provide no assurance that the money supply would automatically be maintained at a level which was adequate, but no more than adequate, to enable the best use to be made of the country's resources. Judgment by the monetary authorities as to whether more or less money was required would be no less necessary under his scheme than under the present system.

61. Under the Loanable Funds Scheme there would be no independent control by the Reserve Bank, apart from any open market operations, and the trading banks would therefore be free to increase the existing level of advances by the equivalent of any increases in savings deposits.

62. Through the possibility of customers drawing suddenly on unexercised overdraft authorities, the banks would always be exposed to the risk of advances rising beyond the limit fixed under the Loanable Funds Scheme. This risk might compel the banks to adopt an ultra-conservative lending policy, by restricting advances until they had built up adequate working balances of loanable funds.

63. An important aspect of banking practice to which the Loanable Funds Scheme appears to attach little significance is bankers' cash. It is apparent to us that a situation could easily arise in which a trading bank had a balance available for lending in its Loanable Funds Account but insufficient bankers' cash to enable lending to proceed. For instance, a trading bank may have secured transfers from free to savings deposits, of, say, £2 million, thereby increasing its ability to lend, according to the Loanable Funds Scheme, by that amount. These transfers would not of themselves effect any change in bankers' cash, but increased lending would cause a drain on bankers' cash which the bank might not be in a position to meet.

64. If a bank's customers transferred through the operation of the cheque system more funds to customers of other banks than they received from them, that bank would lose bankers' cash to the other banks and its ability to make further loans to its customers would deteriorate. This situation could arise at a time when, according to the criteria of the Loanable Funds Scheme, the bank had increased its lending potential.

Possible Run on Savings Deposits

65. The Loanable Funds Scheme gives no protection to the trading banks in the event of a possible run on savings deposits and such a run could easily take place if previously the banks had been pressing their customers to transfer demand deposits to savings deposits. Under the Loanable Funds Scheme it is contemplated that savings deposits would increase substantially. The risk of a substantial draw-off from savings deposits would, therefore, be correspondingly greater. Under the Loanable Funds Scheme, also, advances would require to be contracted on a pound for pound basis to offset the effect of a run on savings deposits. It is clear that the scheme provides no safeguard against fluctuations in bank advances.

Summary of Conclusions Regarding the Loanable Funds Scheme

66. The results of the Commission's deliberations on the Loanable Funds Scheme are now summarised. The 100 per cent money scheme from which the Loanable Funds proposals were developed is not recommended for New Zealand, either by Mr Kelliher or by Mr Colin Clark. Its basic assumption that time deposits can be identified with savings is of doubtful validity if applied to this country at the present time. The Loanable Funds Scheme, which is a variant of 100 per cent money, is based on a similar assumption.

67. By changing the content and meaning of the term "money supply", Mr Kelliher completely destroys the validity of his demonstration that certain transactions increase or decrease the money supply under the existing system, but would not do so under the Loanable Funds Scheme. This change of definition is of the utmost practical importance because it is only money supply in the hands of the public or of the Government which is available for spending by them. The claim that the Loanable Funds Scheme introduces the principle of "*borrowing to lend*" is in our view untenable. The trading banks would create and destroy money under the Loanable Funds Scheme in the same manner as under the present system.

68. In practice, the scheme could also be too rigid to provide for emergencies, while we do not consider that the Loanable Funds Scheme provides a reliable means of limiting bank advances or of avoiding any excessive use of overseas funds.

69. Under the Loanable Funds Scheme, Reserve Bank control of trading-bank lending and investment through the reserve ratio system would no longer exist. Mr Kelliher claimed that the scheme would be self-regulatory. The evidence shows that this claim could not be sustained. In our view, therefore, adoption of the Loanable Funds Scheme would expose the banking system to the very weaknesses which control of the operations of the trading banks by the Reserve Bank is designed to combat. We do not recommend that the Loanable Funds Scheme be adopted.

IV. Insulation of the New Zealand Economy

70. To assist in stabilising the price level in New Zealand, Mr Kelliher suggested that import prices in New Zealand and export incomes should be stabilised by means of what he called *"exchange adjustments"* for both imports and exports.

71. Under the proposed scheme, part of future increases or decreases in the prices of imports and exports as compared with the prices in selected base periods would be absorbed by payments to and from a Stabilisation Account at the Reserve Bank. In this way, farmers would receive only 25 per cent of any increases in price above a *"basic price"*, and would be protected against 75 per cent of any fall in overseas realisations below the *"basic price"*. Similarly, only part of any increases or decreases in import prices would be reflected in the prices of imports in New Zealand currency.

72. The general purpose of the scheme was to limit the effect on prices and incomes in New Zealand currency of price movements in any overseas market. The scheme was not based on *"exchange adjustments"* in the sense of overall variations in the exchange rate.

73. Mr Otto admitted that his insulation proposals were in substance a bounty and levy scheme. We would comment that the real nature of the scheme is disguised by a very complicated series of payments by and to exporters and importers which Mr Kelliher refers to as *"exchange adjustments"*.

Procedure for Stabilising Import Prices

74. Mr Kelliher recognised that because of the multiplicity of import items, and because some were raw materials, some partly processed, and some finished goods, it would be impracticable to make separate

"exchange adjustments" in respect of individual import items. He proposed, therefore, to compile a separate *"import cost index"* for each of, say, three main classifications of imports, based on essentiality, as follows:

"A": most essential imports.
"B": imports of average essentiality.
"C": non-essential imports.

75. Adjustments of exchange rates at six-monthly intervals were suggested on the basis of movements in the above indices. In explaining the scheme, Mr Kelliher gave the following illustration of its working:

(a) If the respective indices or any of them indicate any increase in overseas costs – For the "A" classification (most essential), *reduce* the overseas cost of each consignment by an amount representing 90% of the increase in the index, so that only 10% of the increase would be reflected in internal costs. For the "B" classification (average essentiality) *reduce* the overseas cost of each consignment by an amount representing 75% of the increase in the index, so that only 25% of the increase would be reflected in internal costs. For the "C" classification (least essential) *reduce* the overseas cost of each consignment by an amount representing 50% of the increase in the index, so that only 50% of the increase would be reflected in internal costs.

(b) If the respective indices, or any of them, indicate a decrease in overseas costs – For the "A" classification (most essential) *increase* the overseas cost of each consignment by an amount representing 10% of the decrease in the index, so that 90% of the decrease is reflected in internal costs. For the "B" classification (average essentiality) *increase* the overseas cost of each consignment by an amount representing 25% of the decrease in the index, as that 75% of the decrease would be reflected in internal costs. For the "C" classification (least essential) *increase* the overseas cost of each consignment by an amount representing 50% of the decrease in the index, so that 50% of the decrease would be reflected in internal costs.

76. In an example quoted by Mr Kelliher, importers were required to pay only £8 million in New Zealand currency for imports costing £10 million in overseas exchange. It is not specified by Mr Kelliher whether these particular imports belong to category "A", "B", or "C", but assuming that they come within Mr Kelliher's category "C" in which 50 per cent of any increase in the overseas cost would be absorbed by the Stabilisation Account, this would mean that the overseas cost of the goods had risen by £4 million from £6 million to £10 million. The importer in this case would be called upon to pay 50 per cent of the increase in price and the Stabilisation Account at the Reserve Bank would bear the other 50 per cent of the increase.

77. The effect of this transaction on purchasing power in New Zealand is the same as if under the existing system imports were subsidised from Reserve Bank credit to the extent of £2 million. That is, purchasers of imports get the imports £2 million cheaper than they otherwise would and therefore have that much more to spend on other things. In respect of such transactions, Mr Kelliher claimed that:

there would be no effect whatever on the New Zealand money supply, so that there could not possibly be any inflationary or deflationary consequences.

78. We are satisfied that the effects of the transaction would be just as inflationary as if imports were subsidised from Reserve Bank credit. One of the economic effects of imports is to absorb purchasing power in New Zealand. To meet part of the cost of imports from Reserve Bank credit in any form would mean that so much less purchasing power would be absorbed by the imports. To cheapen imports in this way

would increase the demand for them. The claim that *"there could not possibly be any inflationary or deflationary consequences"* is therefore in our opinion unfounded.

79. Classification of imports in terms of essentiality, as Mr Kelliher proposed, must necessarily present practical difficulties. "Essentiality" will change from time to time with technological improvements, betterment of standards of living, changes in the structure of local industry and employment, and the availability of overseas exchange.

80. There is also a technical objection, that such a classification cuts across normal trade and tariff categories. Motor spirit would no doubt be classified as essential, but this heading would include petrol used for commercial transport which is essential and also petrol used for non-essential purposes. Essentiality or otherwise depends in many instances upon the use made of the import. Wherever essentiality has to be determined an arbitrary decision takes precedence over the wishes of the public whose scale of preferences may not conform to the official pattern. In the past, similar arbitrary decisions have been justified on the grounds of wartime necessity or short-term exchange crises. It is another matter to adopt such a scheme permanently.

81. It may be argued that the determination of high essentiality does not exclude goods but merely gives preference to various classes of goods. In this form the discrimination is in effect a disguised tax on the least essential goods as determined by arbitrary decision.

82. One effect of the proposals would be that in the course of time the real cost of imports, which is the cost in overseas exchange, would become divorced from the price paid by importers and purchasers in New Zealand currency. When prices of New Zealand imports are rising overseas, demand for goods in the most essential class may be sustained because the major part of a price increase to the buyer is eliminated by the stabilisation scheme. In this way desirable shifts to substitutes could be impeded.

83. The uniform exchange rate applying to all commodities within a category would be based on the average change in all prices of such commodities. But the price change for any particular commodity within the category may be very different from the average for the whole category. In the circumstances, applications of the uniform exchange rate to a particular commodity could defeat the protective or other purpose of the Customs Tariff rate for that commodity.

84. For a particular commodity the scheme could abruptly remove or diminish the effect of a tariff protection designed to assist a New Zealand manufacturer. On the other hand it could result in an unintentional protection.

85. Such a scheme could have a highly disruptive effect on both manufacturing and importing businesses in New Zealand. As an importer must always place his orders well in advance of delivery and payment, the variations in exchange rate likely to result from the scheme would introduce disturbing factors which an importer could not possibly anticipate and would result in needless disturbance to business.

86. The variations in exchange rates suggested by Mr Kelliher could also seriously disrupt the arrangements made under the General Agreement on Tariffs and Trade and other international agreements.

87. Mr Kelliher suggested that his scheme did not involve "taxing exports" to subsidise the cost of imports. It is true that there are no taxes as such, but as previously pointed out the practical effect on farm incomes and on prices of imports would be the equivalent of taxes or levies on the one hand and subsidies or bounties on the other. Any additional payments to exporters or importers would be paid in the first place by the trading banks when the transaction was settled in New Zealand currency and recovered later from the Reserve Bank. Any imposts would be received by the trading banks and later paid to the Reserve Bank.

88. Mr Kelliher proposed that the scheme could be used to discriminate against hard-currency imports. This concept is opposed to the ideals of liberalisation of trade.

Procedure for Stabilising Export Incomes

89. The proposals recommended by Mr Kelliher for stabilisation of export incomes were summarised by him as follows:

> Compute the average overseas realisations for all types of produce exported from New Zealand, over a period of say five years immediately preceding the adoption of these proposals, taking into account the different types and grades of produce in each main classification. This computation would be the basic "stabilised price" for all exports, and would apply from the commencement of the insulation scheme – preferably at the end of the export season, and continue for all time.

90. Thereafter in respect of any variations in overseas prices, in any market of the world, part of the variation from the basic stabilised price would be absorbed through what Mr Kelliher called "*exchange techniques*" as follows:

> (a) Increased oversea realisations for any *type* of export at any *time* adjusted by exchange absorption of 75% of such increase so that the New Zealand producer or his representative marketing organisation would be paid the basic "stabilised price" plus 25% of the increase in the overseas price.
>
> (b) Conversely a decreased oversea realisation for any *type* of export at any *time* would be adjusted by exchange absorption of 75% of such fall in price, so that the New Zealand pay-out would be the basic "stabilised price" less 25% of the *decrease* in the overseas realisation.

91. Mr Kelliher's proposal would operate in the following way:

(a) The basic price for each export commodity would be determined according to type and grade on the basis of the average price realised for that type and grade during the immediately preceding five years.

(b) When the scheme came into operation adjustment would have to be made in respect of every shipment of export produce and for each type and grade on the following basis:

(i) If the price realised is in excess of the basic price, 75 per cent of that excess will be withheld from the producer and paid into the Stabilisation Account.

(ii) If the price realised is less than the basic price, 75 per cent of the deficiency would be withdrawn from the Stabilisation Account.

The effect of this proposal would be that the producer would receive only 25 per cent of any realisation in excess of the basic price, and would be required to bear only 25 per cent of any fall below the basic price.

92. Mr Otto admitted that in principle the scheme amounted to a bounty and levy system and that his reason for using the technique of *"exchange adjustments"* was that a subsidy and levy scheme had been *"turned down very abruptly on the grounds that it would never be acceptable to conflicting interests in the community"*. Mr Otto sought to avoid fiscal or other repercussions and so overcome or avoid opposition from conflicting groups in the community. We consider that the scheme proposed by Mr Kelliher merely attempts to conceal the true nature of the adjustments, and that the New Zealand producer would soon become well aware of their true nature. In any event, in our opinion, it is highly undesirable to adopt any scheme designed to hide its purpose and results from those most closely affected, or from the public as a whole.

93. The Kelliher proposal involves serious practical difficulties for wool and for stock sold at auction. It would involve a serious departure from the principle of public auction in that the real cost to the overseas buyer would not be the amount bid in New Zealand currency. This could lead to confusion in comparing New Zealand sale prices with those of overseas sales.

94. Furthermore, the practical difficulty would arise that all wool would require to be appraised as to type and yield before the basic price could be determined, and buyers would have to know the official appraisal before they could work out their bids for particular lots. Although the adjustment takes place when the buyer settles, he is not affected because he will have taken the adjustment into account in making his bid. The benefit of the bounty therefore goes to the producer who also bears the burden of any levy.

95. Wool is classified for sale basically according to type, of which there are approximately eight hundred in New Zealand. There will, however, be varying yields of clean wool within each type. The yield is also a consideration in determining the price which the buyer is prepared to pay. Accordingly, it would be necessary to fix a basic price not only for each type of wool, but also for each yield within each type.

96. Mr Otto considered that the type numbers could be reduced from over eight hundred to fifty. This shows a lack of knowledge of wool marketing. Through long usage the present types are firmly established in all wool importing countries. Any attempt to reduce them to fifty (for our own internal purposes) would not be in the interest of the country. Furthermore, if, overall, sixteen of the present classifications are to be grouped together to form one new type, every new type would comprise wools of varying qualities, styles, and grades. They would also comprise wools which, under normal circumstances, show wide variations in comparative prices. The basic price for each type is to be fixed on the previous five years' average of all wools within the type. The effect of this would be to reduce permanently the existing margins between the better quality wools and the lower quality or less valuable wools. It would be equivalent to placing a levy on the former and giving a bounty to the latter. This would be unjust and would discourage individual growers from improving the quality and presentation of their clip, leading to a progressive deterioration in the New Zealand wool clip.

97. We are satisfied that the need to make allowance in basic prices for variations in yield within each type and the number of basic prices involved would involve such difficulty as to make wool auctions virtually impossible.

98. With meat, as with wool, Mr Kelliher did not satisfy us that he had worked out the application of his scheme to the existing marketing practices.

99. Further, we are by no means satisfied that the scheme proposed by Mr Kelliher would prove advantageous from the viewpoint of productivity and of the best allocation of our resources among the various uses to which they may be put.

100. New Zealand's growing population demands a regular yearly increase in primary production. This is necessary not only to feed the increased population, but also to provide through exports the overseas exchange needed to pay for an increasing supply of finished goods which we cannot economically produce in New Zealand, and for the additional imports of raw materials and equipment which our growing manufacturing and service industries will require. Otherwise the standard of living must fall, and we must find it difficult to maintain full employment of our labour force.

101. Fortunately, there has been a great improvement in farming equipment and in the application of science to farming in recent years. High returns from the sales of the farmer's produce, and the offset against taxation which he has been able to gain from development expenditure, have given him the market inducement and the financial capacity to take advantage of these improvements. This has so far enabled us to keep the volume of farm production more or less in step with our rising population.

102. It would be unwise to adopt any scheme which, if prices rose in the future, took so much of the additional purchasing power away from the farming industry in the interests of stability that desirable development was retarded. It would also not be in our interest to adopt a scheme which so obscured permanent changes in the relative prices paid overseas for our exports that our farming industry had insufficient incentive to switch resources away from the production of those goods which had become relatively less valuable to those which had become relatively more valuable to people overseas. By this we do not mean that the primary industries should switch production in response to every short-term change in overseas demand, but it is essential, if we are to earn as much foreign exchange as we can, that our pattern of production be altered in accordance with longer term changes in the relative prices which people overseas are willing to pay for our various exports.

103. Mr Kelliher's export stabilisation scheme seems to us to be excessively rigid in these respects. An example will perhaps make this clear. Let us assume that butter is selling at its basic price under the scheme, say, 3s. per pound, which is equal to the net price being realised overseas. Due to competition from substitutes the overseas price of butter falls over two or three years to 1s. per pound and remains at that level. If there were no stabilisation scheme in force, those who produced butter would suffer a severe reduction in their income if they persisted in producing butter and they would therefore have every incentive to switch to other products. Under Mr Kelliher's scheme, however, the price producers received in domestic currency would never fall below 2s. 6d. per pound for they are permitted to suffer only 25 per cent of the 2s. reduction in the price of their product. The incentive to switch

production to lines which were much better earners of overseas exchange would be considerably reduced. Similarly, of course, if a particular export product rises in price relative to other products only one-quarter of the increase in its basic price is reflected in returns to the farmer. This is unlikely to provide him with sufficient inducement to turn to the production of this commodity.

104. Mr Kelliher commented that *"seasonal guaranteed prices for dairy produce would be a thing of the past. These . . . are not sufficiently flexible to meet the short-term requirements of dynamic free marketing conditions"*. While there are many arguments about the value of the guaranteed price system most authorities are agreed that one of its greatest values to producers and to internal stability is the fixing of an internal price before the beginning of each season. Within the limits of seasonal climatic and other fluctuations, this enables the farmer to estimate his income for the season, on the basis of which he plans his expenditure including paid employment and development.

105. Mr Kelliher also considered his scheme would provide *"incentives to seek the advantages offered by a rising short-term demand in world markets"*. By absorbing 75 per cent of any increases above the basic price for exports, Mr Kelliher's scheme becomes subject to the same criticism as he levels against seasonal guaranteed price schemes. His own scheme is not sufficiently flexible to meet the short-term requirements of dynamic free marketing conditions. Short-term price advantages would not be worth seeking if 75 per cent of the advantage was absorbed by the Stabilisation Account and the exporter received only 25 per cent of the increase. These advantages are usually prices slightly above those currently offered in the main market. It seems very doubtful whether producers or marketing organisations would take the risk of exploiting such markets for the sake of only 25 per cent of the small gain, which is all they would receive under Mr Kelliher's proposals. Indeed, the costs of exploiting new markets might well be more than the 25 per cent of the gain.

106. The insulation scheme proposed would be likely to cause difficulties in keeping overseas expenditure within export earnings. In a period of falling export and import prices, export incomes would be maintained by the stabilisation scheme and the prices of imports, and particularly of essential imports, would be permitted to fall substantially in terms of New Zealand currency. In those circumstances the demand for imports would be most likely to exceed the overseas funds being earned. The position in this respect would be even worse if export prices fell and import prices rose.

107. If, for the reasons mentioned above, the demand for imports exceeded the overseas funds being earned, the trading banks would have no option but to ration overseas exchange, because under the Loanable Funds Scheme they would not be permitted to sell to their customers more than current annual receipts of overseas exchange.

108. Mr Kelliher agreed in principle that *"incomes of one section of the community must be related to the incomes of other sections"* and he suggested that the fixing of prices for primary products was therefore the responsibility of the State in its overall stabilisation policy. A difficulty with stabilisation schemes is not only to deal fairly with the

sections of the community competing for shares of the national income (and that is difficult enough), but also to secure acceptance of these schemes by the main sections in the community.

109. The introduction, after a period of rising import and export prices, of a scheme for stabilising internal prices such as that proposed by Mr Kelliher appears to us to be open to the following disadvantages:

(a) Farm incomes would necessarily suffer an immediate reduction because the basic price would be computed on the average of the previous five years.

(b) At the commencement of the scheme and in the period following, farm incomes stabilised on the basis of an average for the last five years would bear a less favourable relationship to import prices than they had before the commencement of the scheme. The latter would be stabilised on the basis of the six months prior to commencement of the scheme.

(c) Internal costs and prices generally would presumably be stabilised in relationship to prices at the commencement of the scheme.

In the above circumstances farmers would be at a distinct disadvantage, because their incomes would be stabilised on a relatively lower level than their costs.

110. We are satisfied that the scheme for insulation of the New Zealand economy should not be adopted because:

(a) It is in substance a scheme of bounties and levies disguised as so-called *"exchange adjustments"*.

(b) In certain circumstances the scheme could maintain the demand for imports beyond what could be paid for from current earnings.

(c) Through its effects on import prices, the scheme would upset existing tariff protection, including margins established by international agreements.

(d) The resultant changes in import prices could be most disturbing to New Zealand industries competing with imports.

(e) In detail the scheme appears incapable of practical application with the existing market practices for meat and wool.

(f) It would minimise the effects on farm incomes of permanent and severe reductions in price for any particular export commodity, and thus remove the greater part of the incentive for farmers to change to another product.

(g) It would remove the greater part of the inducement to farm development which increased prices provide, and would likewise remove a substantial part of the financial resources available to finance farm development.

(h) The scheme as a whole could operate very unfairly for the farming community, especially if introduced after a period of rising costs.

111. In final result Mr Kelliher's very complicated and very inflexible scheme could achieve no more than could be done by much less complicated and more flexible methods. We agree that there are times when it may be beneficial to adopt a general stabilisation scheme or to take special measures to avoid very great fluctuations in export incomes such as occurred in the recent wool boom. Nevertheless, we are not satisfied that such schemes should be introduced as a permanent

feature of the economy with a view to reducing all price fluctuations to a minimum. If it were desired at any time to introduce a permanent overall stabilisation scheme, then, for the reasons given, we could not recommend Mr Kelliher's scheme.

V. Capital Investment

112. As a supplement to his Loanable Funds Scheme, Mr Kelliher made proposals which he described as *"Methods for Rational Allocation of Investment Among Competing Needs"*. These proposals were intended to be considered in conjunction with his suggestions for raising the level of private savings.

113. In introducing his proposals, Mr Kelliher made the following observations, *inter alia:*

(a) For some years, the demand for capital investment had been heavy and it was likely to remain heavy because of the need to make proper provision for an increasing population and an economy which was expanding rapidly.
(b) The savings of the community had not been sufficient in recent years to match the rate of capital investment.
(c) The excess of investment over savings had been met by the creation of new money which had been the major cause of inflation.
(d) Unless voluntary savings could be raised to a much higher level, regulation of capital investment must be continued, because the high level of spending by the public in conjunction with the heavy demand for capital investment was overtaxing the physical resources of the country.

114. Mr Kelliher contended that the existing restrictions on capital expenditure, maintained through building, capital issues, and local body controls, were not satisfactory because, *inter alia:*

(a) Suggestions have been made that the private sector has not been fairly treated in the competition for scarce economic resources, and for access to the necessary investment funds. There is very strong feeling indeed that the Capital Issues Committee has exercised a bias towards the satisfaction of national requirements rather than private, and that its actions are coloured very strongly by Treasury policy.

(b) In the Local Body field also there is dissatisfaction with the administration of the Local Bodies Loans Board, and more recently with the grave shortage of investment funds available at the controlled rate of interest.

(c) . . . the controls have not been applied effectively or equitably and also because as a people we resent direct control against the investment plans of individuals, businesses, firms, or local bodies.

115. It is patent from Mr Kelliher's proposals that he seeks to control the amount and direction of capital investment, at least until the time is reached when savings are adequate to match investment. He believes, however, that this can be done more effectively by the methods he proposes than by the existing controls.

116. The procedure he suggested was briefly as follows:

(1) Obtain annually from the private sector Budgets of immediate as well as projected capital development – this should be sought not only from companies but also from private businesses, and should include housing construction budgets from Building Societies, Insurance Companies and similar institutions.

(2) Obtain annually from each State Department and local authority similar Budgets of immediate and projected capital developments, including housing.

(3) Having regard to State priorities in the provision of capital investment essential for the welfare of the community, and having regard to the total level of current private savings which may be anticipated in any year, allocate to the State and to local bodies the share of savings available for public investment purposes . . .

(4) To the extent of the residue of current private savings over and above the allocation for capital investment to the public sector, allocate such savings as follows:

(a) On an industry basis, classified in accordance with economic priority – greater investment in the industries whose needs for capital development are greatest on the criterion of social good. The proportion of permitted capital formation should be greater for high priority industries than for those less essential to the public good.

(b) Allocation to *industries* to be determined on a percentage of subscribed capital plus reserves, that is to say "shareholders' funds", invested in each industry classification . . .

117. In brief, Mr Kelliher proposed the computation of an annual estimate of savings from current incomes and their allocation among the Government, local body, and private sectors. He recognised the need for essential capital development in an expanding economy, but believed that it should be financed from current savings if inflation were to be held in check. In current conditions of inflation he considered that investors would generally prefer industrial securities to Government and local body securities, as the former generally responded in price to inflation whereas the latter two had a fixed redemption value, so that when money lost its purchasing power there was a loss of capital.

118. It would appear from the submissions that, in the allocation of funds for investment in the prevailing circumstances, preference would be given to the requirements of the Government and local body sectors, although it was clearly intended that the basis of allocation as between the various sectors would be changed from time to time according to circumstances. In the Government and local body sectors the allocation for investment made to each would be determined according to the degree of essentiality of the proposed works. The allocation of the private sector would be ascertained, in the first instance, by requiring each unit in the sector to furnish, as an addendum to the annual income-tax return, a budget of immediate capital requirements in the succeeding year, together with an estimate of general requirements for the next succeeding two or three years. The amount of savings allocated to the private sector would then be determined on an industry basis, having regard to the needs and the relative importance of each industry in the economy. Each industry's allocation would, in turn, be divided among the units in the industry, or those which had provided a budget of their requirements, as a percentage or ratio of shareholders' funds, allowance being made for new units in the industry. By the above means Mr Kelliher expected to dispense with the existing controls on investment such as capital issues, building controls, and the like. In the initial stages of the scheme, it was proposed, in the public interest, to put the greatest emphasis on the requirements of the Government and local bodies. As the requirements of these sectors diminished, an increasing share of savings would be made available to the private sector.

119. In examining the proposals for the allocation of moneys likely to be available for investment, we must necessarily look at the difficulties which are likely to be encountered in implementing them because, unless these can be satisfactorily overcome, the scheme is not likely to work. The first difficulty is estimating savings out of current incomes, as the

success of any scheme for the allocation of funds will depend in a great measure on the accuracy of the savings forecast. This, by itself, is an extremely difficult task, which requires an accurate forecast of the habits of spending and saving of the people. In a time of inflation reliable precedents on which to base an estimate are usually lacking because of the lack of stability in the economy.

120. Apart from the difficulties inherent in making an estimate of savings, the allocation of the savings between the various sectors of the economy, in a manner likely to prove generally acceptable, might well prove to be an even more difficult problem. It would involve the consideration and determination of priorities in fixing the overall requirements of each sector. This might not be so difficult in respect of the Government and local body sectors, but in the private sector, which in recent years has been responsible for a large and increasing proportion of capital expenditure, many of the problems which would arise appear almost insurmountable, both with respect to reliable estimates of expenditure and a reasonable and equitable allocation of the available funds. Somebody would have to determine the percentage basis of allocation for each industry. In our view this determination by official fiat of the extent to which all the businesses in an industry could incur capital expenditure, would constitute a far more onerous control than the existing controls operated through the Capital Issues Committee and the Building Controller. Thus while seeking freedom from controls, Mr Kelliher would impose more onerous controls than those which now exist.

121. Mr Kelliher, in his submissions, stated that attempts made in the past in other countries to compile a budget of capital expenditure for the private sector of the economy were not conspicuously successful. We agree that there would be a temptation to over-estimate requirements, prompted by the belief that some scaling down would be necessary in order to equate demand with supply. In the long-range estimates, difficulty would most certainly be experienced in forecasting with any degree of accuracy. Changes in economic conditions, and other circumstances, would frequently necessitate amendment to earlier intentions and forecasts. Even if the problem of the budget of proposed expenditure could be resolved in a generally acceptable way, the real problem of an equitable allocation of money resources would remain. Mr Kelliher's proposal was that this allocation should be made on the basis of shareholders' or proprietors' funds. In the case of a limited liability company, "shareholders' funds" means the paid-up capital plus all free reserves, which is another way of expressing what is commonly called "the shareholders' equity". In a privately owned business the proprietors' interest or equity would be the relevant factor. An allocation of money resources, as a ratio of proprietors' or shareholders' equity, would not, in our opinion, be likely to meet the varying needs and circumstances of a great variety of businesses. In cases where the proprietors' equity is high in relation to total assets, the share or allocation of funds would be greatest. These, however, would also be cases where the finance was more soundly based and therefore the very instances where it had probably been found possible in the past to make reasonable provision for future expansion. With two companies or businesses in which the assets were equal in value, the one in which the proprietors' funds bore the highest

ratio to assets would, all other things being equal, experience the least difficulty in arranging finance for development. The proprietors' equity, as a basis for allocation of available funds, appears likely to make the allocation in inverse ratio to needs.

122. Another very serious objection to the percentage or ratio basis of allocation is the economic waste which is bound to result from the freezing or immobilising of a large sum of money representing capital development proposals which cannot be completed because of the lack of an adequate allocation of money resources. It is apparent that, in a majority of cases, rationing by ratio would result in an allocation that would bear no relation to the value of the capital works to be undertaken. The construction of such works would have to be spread over an unduly and unnecessarily long period. The delay in bringing them to the stage at which they would become income producing would involve the country in a great deal of avoidable economic waste.

123. In introducing his proposals, Mr Kelliher referred to a strong feeling in the community that the private sector had not been equitably treated in the allocation of investment funds by the Capital Issues Committee which had exercised a bias towards the satisfaction of national requirements. His basis of allocation of investment funds would make available to the private sector only *"the extent of the residue of current private savings over and above the allocation for capital investment to the public sector"*. From this it seems clear that the private sector would not receive a positive allocation but merely a residue. In our opinion the allocation to the private sector would be less favourable than at present.

124. It is important to point out that Mr Kelliher's suggestions for the allocation of investment funds are intended to operate in conjunction with his Loanable Funds Scheme, and its associated proposals which include the freeing of interest rates from the existing controls.

125. Our conclusions respecting Mr Kelliher's proposals for the allocation of investment funds are:

(a) They might operate satisfactorily in the Government and local body sectors because reliable information about the cost and degree of urgency of Government and local body projects for development is readily available. In current circumstances the Government obtains a substantial share of the finance which it requires for capital investment from savings effected through such channels as the Post Office Savings Bank, national savings, the Government Life Insurance Office, and from taxation. Mr Kelliher does not contemplate any change in the availability to the Government of funds from the above sources. His proposals do not appear to contemplate any significant change in the prevailing methods as applied to the Government sector.

(b) In the local body sector it is apparent that Mr Kelliher proposes to dispense with the existing control by the Local Government Loans Board over local body works. It would appear, however, that the authority which he proposes to set up to control the whole question of an allocation of investment funds would be required to make an allotment of funds to the local body sector. In doing this it would have to decide priorities as between a number of competing interests. So long as control

is considered necessary, we are of the opinion that it is preferable that it should continue to be exercised by the Local Government Loans Board which has already acquired a wide experience in this class of works.

(c) For the reasons set out above we consider that Mr Kelliher's proposals in respect of the private sector are unrealistic and quite impracticable. If imposed, they would constitute far more onerous controls than those at present existing.

We strongly recommend that Mr Kelliher's proposals described as *"Methods for Rational Allocation of Investment Among Competing Interests"* should not be adopted.

VI. Suggestions for a Realistic and Equitable Wage Policy

126. Our order of reference contemplates as a national objective the maintenance of full employment of labour. Mr Kelliher, in his submission, went further and recommended that *"the State should positively guarantee full employment in New Zealand"*. The Commission does not think it is called upon to comment upon this recommendation.

127. Mr Kelliher stressed the great social need for stable purchasing power of the salaries, wages, pensions, and other incomes of the people, and claimed that the adoption of his proposals would achieve avoidance of monetary inflation, insulation against external price repercussions, and equation of current savings with investment. By this course he believed a relatively stable price level would be attained. He considered, however, that any improvements in the standard of living must depend upon increased production, that, to achieve such increased production, incentives must be provided for workers in industry, and that the fruits of production must be equitably distributed.

128. Mr Kelliher therefore proposed that wage rates should be tied to productivity and should rise *only* to the extent of the annual increase in production over the whole of the economy.

129. We make the following comments upon the proposals:

(a) While wage rates would be stabilised except for increases warranted by overall increases in productivity, the incomes of primary producers under Mr Kelliher's scheme of insulation would not be stabilised to the same extent. Between 1947–48 and 1953–54, the export prices index rose from 77·4 to 113·8 and the index of productivity per unit of total labour force increased from 102 to 115 (provisional). If it be assumed that productivity in primary producing industries rose to the same extent as the index of overall productivity, and the Kelliher formula had been applied, the payout to the primary producers would have increased during the period by 26 per cent while wage rates would have been increased by only 12·7 per cent. Again, if the formula had been applied between 1951–52 and 1953–54 – during which period the export prices index rose from 100·5 to 113·8 and the index of productivity from 113 to 115 – the payout to the primary producer would have increased by 5·1 per cent and wage rates by only 1·8 per cent.

(b) It seems quite possible that in circumstances akin to the position in which the dairy industry recently found itself, the payout to all primary producers under Mr Kelliher's scheme would fall despite the benefits of increased overall productivity and partial insulation. A situation would then arise in which all wage rates would be raised in accordance with the increased productivity, while the incomes of the primary producers would fall. It seems very doubtful whether such a situation would be tolerated.

(c) Wage rates which, up to the present have usually been the main issue in industrial disputes, would be eliminated from the field of collective bargaining. We do not think this innovation would be welcomed either by organised labour or by management.

(d) Wage adjustments related to changes in productivity would necessarily be delayed for practical reasons.

(e) The stabilisation of wage rates at present levels, except for adjustments based upon increased productivity, would perpetuate present wage relationships and any existing anomalies. Such a step would definitely not be conducive to good industrial relations, nor would it assist in the effective functioning of industry in general.

(f) An increase in wages is not the only form in which benefits of higher productivity have been or may in future be distributed to workers. Shorter hours, longer annual holidays, rest periods during working hours, supply of industrial clothing, better working conditions, and improved social services all benefit the worker and all involve a charge against increased productivity. To the extent that the cost of any such future improvements would have to be met, so would the progressive increase in rates of wages have to be less than the estimated gain in productivity. This would doubtless give rise to much industrial controversy.

(g) Mr Kelliher contended that if workers had the knowledge and assurance that the price level would be held relatively stable, and if rates of remuneration were related to rates of production, there would be an incentive to increase production. If future increases in wages were based on long-term trends of productivity in the past, we do not think that there would be any appreciable incentive to increase production. Even if wage rates for a current year were based on overall productivity for the previous year – ignoring the difficulties of prompt compilation of the necessary index – we doubt whether it would prove an effective incentive, for the reason that incentive is largely a matter of individual appeal with the prospect of immediate or very early beneficial results.

(h) If long-term tendencies in productivity were used for the determination of short-term wage adjustments, we consider that grave economic difficulties would be encountered. On the other hand, if short-term tendencies in productivity were followed, the possibility of wage reductions would from time to time have to be faced.

(i) It is possible that general price levels could fall. In such circumstances it would not necessarily be equitable that wage levels should continue to rise proportionately with increases in productivity. Indeed if they did so, unemployment might be likely to ensue.

(j) In a dynamic and reasonably free economy there is continuous need for flexibility in wage fixation in the various industries, depending on changes in economic environment, ability to pay, and so forth. A notable example of such flexibility in New Zealand has been the manner in which the wage rates of shearers have been determined for a number of years by relating them to the prices received for wool.

(k) Again, variations in productivity must occur in different industries and it is conceivable that, for one given period, some industries would show increases in productivity well above the overall average for the Dominion. Under the proposals placed before us, the workers in such industries, could not receive commensurate recognition through an increase in their wage rates until all workers throughout the whole of industry achieved, on the average, a similar increase in productivity. Indeed, they might even suffer a reduction in wages through a drop in average productivity per head of population. We do not think that the rigidity inherent in the scheme would be acceptable to the parties directly concerned or be in the best interests of the public.

130. We conclude that Mr Kelliher's suggestions on wage policy are an attempt to over-simplify the complex problem of wage determination, and that, despite his contentions, they do not constitute a realistic and equitable wage policy. At the same time it should be mentioned that productivity is not ignored under the present system of wage determination. One of the considerations which the Court of Arbitration is required to take into account in making a general wage order under the Economic Stabilisation Regulations 1953 is *"any increase or decrease in the volume and value of production in primary and secondary industries of New Zealand"*. (Regulation 3 (3).)

VII. Other Ancillary Proposals

131. In Parts IV, V, and VI of this Appendix we comment on the ancillary proposals put forward by Mr Kelliher in connection with insulation of the New Zealand economy, the allocation of capital investment funds, and suggestions regarding wage policy. Other ancillary proposals made by Mr Kelliher, e.g., those for raising the level of private savings and for their mobilisation, for freeing interest rates from control, and for a permanent Council of Economic Advisers, are examined in the sections of our report dealing with such subjects.

Appendix G

COMMODITY CURRENCY PROPOSALS

1. Mr Colin Clark, M.A., Director of the Institute of Agricultural Economics, Oxford, England, and formerly Economic Adviser to the Government of Queensland, who was visiting New Zealand, was invited by the Commission to give evidence. He advanced proposals for stabilising the value of our currency. These proposals are best explained in Mr Clark's own words:

. . . there has recently been among economists some original and useful thinking on how a currency's purchasing power could be maintained by giving it a proper backing, without causing depressions or falling prices. The solution to the problem is that currency should be backed, not by gold, but by stocks of commodities. This would genuinely preserve the value of the currency against both downward or upward fluctuations. Reserve Bank credit would be issued against stocks of commodities, and against them only. Stocks of commodities could always be exchanged for money, and money for stocks of commodities. This would mean that either a serious rise in prices, or a serious depression, would alike become impossible. If a depression threatened, the producer would know that he always had the right to hand over his stocks of commodities, and to receive a fixed amount of money in exchange. The consumer would know, on the other hand, that he would always be able to get the same amount of goods in exchange for his money. If prices were showing a tendency to rise, stocks of commodities would be drawn upon, the issue of new money would be checked, and some of the existing currency withdrawn until equilibrium was restored.

It should be made clear, however, that the use of this form of currency would stabilise prices in general, but would not stabilise the price of every single commodity (which would not be desirable, even if it were practicable). The producer would be protected against a general fall in prices, but he would still be expected to switch production from one commodity to another, as their relative economic value changed.

The method by which currency would be issued and the price level in general stabilised, while leaving the prices of individual commodities free to fluctuate, would be as follows:

The Reserve Bank would prepare a list of the staple commodities whose stocks could be taken into account, and of the relative importance of each. This list of commodities, and the figures provided for the relative quantities to be taken into account, could not be changed, at any rate for a long period of years. Reserve Bank credit would only be issued (in the form of currency notes or Reserve Bank advances) to brokers who could deposit with the Reserve Bank warrants or liens giving them possession over stocks of *all* of the specified commodities, with the quantities in the correct proportions. It is unlikely in fact that any broker or merchant would himself have stocks of all the required commodities and he would have to hire, for a few months at a time, liens from other merchants (and might have to pay quite a high interest rate on them at a time when commodities were scarce).

The broker could not himself directly use a Reserve Bank credit, but would deposit it with his trading bank (who would offer him interest on it). At the same time the trading banks would be required (as now) to hold a specified proportion of all their assets in the form of cash or Reserve Bank credits. This proportion, which would probably be somewhere between 10% and 20%, would have to be finally and definitely fixed, and also made unalterable over a long period of years.

When choosing a list of commodities to act as a basis for the currency, it is of course desirable to choose those which can be stored for long periods, and whose specifications do not change too considerably. For most countries it would be fairly easy to draw up a list of staple commodities. In New Zealand however it might make a considerable difference according to whether export or import commodities were chosen. Choosing the former would do more to stabilise the incomes of producers, the latter to stabilise the purchasing power of consumers. These two desirable objectives are, to a certain extent, incompatible. It would probably be desirable to prepare a list including export and import goods in more or less equal proportions.

The stored commodities would at no time become the property of the Reserve Bank. They would remain the property of merchants, brokers, farm co-operatives, etc., who would also remain responsible for meeting storage costs. In other words, they would be lent, rather than sold, to act as a basis for the national currency.

Such a system, once instituted, would be technically very easy to administer. It might however find itself, on many occasions, under tremendous political pressure to issue additional currency, at a time when available stocks of commodities did not justify it. In countries like Australia, Canada, or the United States, which have a written Constitution which cannot be altered by a simple Parliamentary enactment, but only by a referendum of the whole people, or similar lengthy procedure, any such provision for safeguarding the currency could be inserted in the Constitution, and thereby protected against political pressure. It is not clear whether any such provision is possible in New Zealand.

It is however important to make the point that, while the prevention of changes in the value of the currency is our principal objective, nevertheless it is not possible to check fluctuations by controlling the supply of currency alone. In general terms, to fulfil the objective of checking undesirable economic fluctuations, whether upward or downward, it may be necessary to regulate from time to time (though not always necessary to regulate all of) the following:

Supply of currency;
Rates of taxation;
Government expenditure on both capital and current accounts;
Certain forms of private capital expenditure; and possibly also business stocks.

Governments now find it fairly easy to regulate economic fluctuations by changes in budgetary policy. To check a downward fluctuation, they can either incur expenditure or remit taxation. Such procedure of course would not be so easy when the stock of money was strictly regulated, according to the stock of commodities, for the Government just as much as for any other borrower. In order to be able to have the financial resources necessary to meet a downward economic fluctuation if it came, any prudent Government, in such circumstances, should keep, at all times, a considerable cash reserve.

Finally, it is clear that, when stability of prices has been achieved, general increases in wages will then only be possible insofar as the general productivity of the country, per man-hour of labour performed, has increased, or there has been a marked and sustained improvement in the terms of trade on which the country can exchange its exports for imports, or that it is practicable and desirable permanently to increase labour's share in the national product, at the expense of the shares of property and enterprise. The extent of the general increase in wages permitted by such increase in productivity etc. should be determined at three-yearly intervals by a special commission formed by trade unions, employers and the Government each nominating qualified statisticians and economists to represent them.

2. Examined, Mr Clark said that the commodity currency scheme had not been tried in any country in the world and had been under discussion for only a short period. In the absence of practical test, the Commission has had to base its recommendations on close analysis of the theory.

3. It is clear that the scheme would have a limited value to New Zealand unless it would stabilise the average of the prices of the main exports and imports, since New Zealand's external trade is a large proportion of her total trade.

4. Basic needs of the scheme appeared to be:

(a) An adequate stock of the chosen commodities.
(b) Choice of durable commodities which will not deteriorate with storage.
(c) Choice of commodities which would include some of the chief items of external trade.

(d) Operation in conjunction with a flexible exchange rate, and without Government interference.

5. Mr Clark expressed the opinion that, to operate the scheme, the total value of stocks of commodities would need to be between 10 per cent and 20 per cent of the total volume of money and that the chosen ratio would have to be permanent. If 10 per cent were the ratio and it was based on the volume of money at the end of June 1955 (£317 million), stocks valued at between £30 million and £32 million would be needed.

6. Mr Clark gave it as the opinion of economists supporting this scheme that between twelve and one hundred commodities would be needed. In his opinion between thirty and forty commodities would be needed to stabilise prices effectively in New Zealand.

7. He explained that the choice of commodities depended largely on objectives. A scheme designed to stabilise the price of exports in New Zealand currency would involve choosing a range and type of commodities in which greater weight was given to our exports.

8. At least 85 per cent of New Zealand's export income, on which our economy is based, comes from the sale of dairy products, meat, and wool. Deterioration in quality during lengthy storage makes dairy products and meat unsuitable as commodity stocks. Mr Clark agreed that this would seriously limit the usefulness of the scheme in New Zealand.

9. Wool is durable but, as it is the product of a comparatively short season, it would provide adequate commodity stocks only during a relatively small part of the year. The method of marketing wool raises another more serious difficulty. As weather allows, the bulk of the wool clip is shorn between the beginning of September and the end of December. It is sold at a series of auctions in various centres from about October until the following May. Once sold the wool becomes the property of the purchaser who is an overseas buyer except where the wool has been bought for domestic use. This local demand absorbs only a small part of the clip. Shipment overseas is made as soon as possible after the sale, so that comparatively little wool is carried in stock in New Zealand, except for the short period during the season's peak.

10. When these circumstances were explained to him, Mr Clark appreciated the difficulties and suggested that a broker might be able to obtain a lien over some of the stocks sold at auction on condition that they remained in store for a specified period of months. Mr Clark was then reminded that the wool market is subject to sudden price changes which would make it difficult and almost impossible to persuade overseas purchasers to allow their wool to remain in stock in New Zealand for several months. In these circumstances, he suggested, it might be necessary to obtain liens on wool held overseas, but he admitted that this would probably involve payment of a high rate of interest.

11. In view of (a) the importance Mr Clark put upon wool as a commodity stock and the difficulties in the way of using it, and (b) the unsuitability of dairy produce and meat as commodity stocks, it is difficult to see how the commodity currency scheme could be used successfully to stabilise export prices in New Zealand currency.

12. Mr Clark agreed that storage operations by New Zealand could not affect the prices of imports and said that his proposal would only

work in New Zealand with a moveable exchange rate. Such an exchange rate, with changes made from time to time on the basis of changes in the balance of payments, would not necessarily stabilise internal prices and costs. For example, if balance of payments difficulties were caused by internal inflation the exchange rate would rise, thereby increasing the cost of imported goods and giving to exporters a greater share of the national income. Wage rates in New Zealand are influenced by changes in the consumers' price index, which, in turn, is affected by changes in the cost of imported goods. A steady rise in the rate of exchange could cause a spiralling of the prices of consumer goods and wage rates which would eventually frustrate the purpose of the change in the exchange rate.

13. Mr Clark considered it essential that the commodity currency scheme should be administered by an authority independent of Parliament. Administration in this way would certainly be necessary to the successful operation of the scheme, but it would be impracticable in New Zealand and, in any event, quite unacceptable in a democratic community.

14. Mr Clark agreed that the commodity currency scheme would not of itself be enough to prevent fluctuations in the economy. He admitted that it would still be necessary for the Government to use its judgment on what fiscal measures and additional monetary measures were needed in the public interest.

15. Other difficulties of the scheme which in our opinion render it unsuitable for adoption in New Zealand are:

(a) It would be costly to administer. In Mr Clark's own words, *"If we could rely on the discretion of Government and bankers and have a purely fiduciary currency it would be very much cheaper"* (than a commodity currency scheme).

(b) It would be difficult to institute the scheme during a period of rising prices. Further increases in prices would probably be required in order to acquire the necessary stocks of commodities. This would aggravate inflation at a time when every effort should be directed to checking it.

(c) According to Mr Clark, specialist brokers would be required to obtain the stocks of the selected commodities in the right proportions as the basis for the issue of currency and credit by the Reserve Bank. In our opinion great difficulty would be experienced by these brokers in persuading exporters and importers to part with the title to and the control of their goods (which may be subject to sudden changes in prices) even for a money consideration by way of interest.

16. Proposals for an *"automatic currency"*, very similar in its basic principles to Mr Clark's commodity currency, were made in written submissions by Mr A. N. Field, of Nelson. Mr Field's proposals did not, however, involve a stock of commodities. Under his scheme dealings would be confined to *"titles"* to commodities. The absence of a stock pile could in certain circumstances cause quite serious difficulties which Mr Field acknowledged in his submissions in these words:

> The position would not be so simple in a time of rising prices, with no commodity stock piles to draw upon. With market prices above the Bank's selling prices, purchasers of our export commodities would all be inside the Bank to buy at its lower figure. The Bank would have no means of meeting the demand. The best

we could do would be to give the Government power, on request of the Bank, to suspend the buying obligation for thirty days, with extensions of 15 days at a time as necessary. This would give the bank time to tighten up financial conditions sufficiently to stop any demand on it.

17. New Zealand support for adoption of a commodity currency scheme on an international basis was proposed in a written submission by Mr I. W. Weston, of Christchurch.

18. Useful information about international commodity reserve currency schemes is to be found in a report of a Committee of the United Nations Organisation on *Commodity Trade and Economic Development* published in 1953. The Committee was composed of a number of leading world economic authorities, and was presided over by Professor J. Goudriaan, one of the originators of the commodity currency proposals. It had the benefit of the advice of a number of leading economists, in particular the advice of Mr Benjamin Graham, one of the foremost exponents of a commodity based currency.

19. It is clear from the Committee's report that commodity currency proposals need further examination and consideration before a decision could be reached on their suitability as the basis for an international commodity currency. The following are some observations made by the Committee on the proposals it examined:

An ideal standard of value would be related in the same way to all goods and services entering trade; but of course the number of distinguishable goods and services is extremely large, and the services are difficult to define in a standardised way, while goods (especially manufactured goods) are constantly changing with technical progress and changes in taste and fashion. In practice, the number of items included in the commodity unit has to be cut down from possible thousands to perhaps ten or twenty. This means that the scheme will operate only imperfectly in stabilising the value of money, and that supplementary measures to deal with particular price problems or distortions may be needed. But the degree of correlation between prices is so great that there is reason to hope that the stabilisation of the prices of a few major commodities would exercise a powerful influence in lessening fluctuations in other prices.

The practical criteria which must be met by commodities to be included in the unit are these:

(a) They must be goods in general use, not liable to large changes in specification or style; and likely to maintain their role in economic life for a considerable period;

(b) They must be merchandised in well known and clearly defined standard grades or qualities;

(c) They must be storable for a reasonable time (at least a year) without serious deterioration, physical loss or excessive cost;

(d) They must be sufficiently important in economic life to warrant the trouble of enlarging the unit to contain them." . . .

. . . the importance of commodities in world production diminishes rapidly as we go down the list. It seems reasonable to suggest that the scheme would not have enough stabilising influence with fewer than ten commodities, nor be conveniently workable with more than thirty. Some special problems are:

(a) Whether to include such commodities as wool, tea, skins and hides, and timber, which are sold wholly or in part at auctions and whose classification into standard grades presents technical difficulties.

(b) Whether to include agricultural commodities and minerals in the same composite unit. Their price characteristics are very different, the agricultural commodities being in general less flexible in supply but having in most cases a steadier market than the minerals. In fact, the cyclical movements of prices in the two groups have been similar, and . . . the fear that they might de-stabilise each other seriously, if tied together in the same commodity unit, may be unfounded.

(c) Whether to include such minerals as coal, petroleum, pig-iron, steel and aluminium, which are subject in some countries to price regulations by private interests.

These are technical matters which would require special examination at the time of establishing of the scheme. It may be worth noting that any excluded commodities could be separately stabilised by ordinary (non-monetised) individual or collective buffer stocks. Indeed, subsidiary buffer stocks would stand a much better chance of success if the price level of more important basic commodities had already been stabilised.

20. Some of the points recommended for further study were, *inter alia:*

Is the stability of a commodity unit over a period of years desirable in itself, or does economic progress go faster under the stimulus of a slightly rising price level? Precisely what economic conditions must be satisfied before the commodity reserve currency system can operate? Do they, for instance, include universal convertibility of currencies?

It is not certain how far the scheme when modified to soften its impact on the rigid elements of the economic system, would remain effective. Thus, if the full autonomy of central banks is preserved, may they not use their power to frustrate and distort the policies of the stabilising authority? If free wage bargaining is permitted, will it be possible to hold wages beneath the limit set by the slow change of productivity, without resort to the discipline of heavy unemployment? . . .

If the scheme requires revision by bringing in new commodities, dropping commodities already included or altering the weights, can the resultant transitional problems be overcome without serious hardship to producers or consumers? . . .

It may also be asked whether the attractiveness of the scheme as an automatic stabilising device is not seriously compromised by the degree of flexibility that must be introduced in order to make it work in a complex and dynamic world and by the frequent revisions in the commodity unit and its valuation that may be necessary . . .

The commodity reserve currency scheme has to be judged, not only against the present situation but against possible enlightened alternatives. Its advantages lie especially in its automatic operation on an important source of variability. But is it from the money side, better than other forms of monetary management? It can be argued that success in this field depends more on the quality of the managers than on the ingenuity of the scheme of management; in each country the "managers" include, in a sense, all citizens who share in effective power.

21. The report concludes with the following paragraph:

This is not an exclusive list of questions requiring study and answer. We found ourselves sufficiently attracted by the scheme to think further effort worth while. This is as much as we, as experts, can say at this point. For obvious reasons, we did not enquire into the problem of political feasibility; but we are not, of course, unaware of it. What the world has to decide is whether the degree of stability to be expected from schemes of this kind is worth the change in habits and thinking which would be required.

22. One of the members added the following note to the report, *inter alia:*

I wish to state that, though fully associating myself with the idea expressed . . . and, especially, with the recommendation for further study of the commodity currency scheme, it is obvious to me that a proposal like this is not now within the reach of practical politics. I have grave doubts whether the system can work satisfactorily in the world as it now exists or is likely to exist in the foreseeable future. The great virtue of the scheme – automaticity – seems also to be its great defect; it may prove impossible to remedy its defect without losing its virtue.

Conclusion

23. To sum up, we do not recommend the adoption of a commodity reserve currency scheme by New Zealand alone, for the following main reasons:

(a) Its usefulness in New Zealand would be limited because meat and dairy products deteriorate in storage, and because it would be difficult to arrange for the accumulation of stocks of wool.

(b) New Zealand could not influence the prices of exported or imported goods to any great extent by practicable storage operations.

(c) It follows from the above two considerations that the scheme would have to be operated in conjunction with a flexible exchange rate. But changes in the exchange rate might, in certain circumstances, merely aggravate inflation in New Zealand.

(d) During a period of inflation, it would be difficult to accumulate the stocks necessary to initiate the scheme without aggravating the inflation.

(e) The scheme would be costly to administer and great difficulties would face brokers attempting to acquire titles to the required stocks.

(f) Adoption of the scheme would not guarantee that the supply of money was adequate, and no more than adequate, to serve the best interests of the country, taking all objectives into account. Judgment by the Government and the monetary authorities would still be necessary as to the fiscal and monetary policy which should be adopted.

24. Neither do we recommend that New Zealand should press for the adoption of a commodity reserve currency scheme on an international basis. The report of the Committee of the United Nations makes it clear that there are many questions which demand study and answer before such a scheme could be safely introduced. If the commodity currency scheme could be developed to a point where it was generally acceptable as a basis for an international currency, its adoption universally might have some advantages for New Zealand in view of the fact that so large a part of our trade is external.

25. Until such a stage is reached, however, it appears to us that the scheme has no worth-while advantages to offer.

Appendix H

STATISTICAL TABLES

Table No.

TABLE 1

New Zealand Mean Population (including Maoris), 1934 to 1955

Year Ended 31 December	Males				Females			
	0–14	15–64	65+	Total	0–14	15–64	65+	Total
1934(1) ..	214,079	528,987	46,967	790,033	205,222	509,620	45,413	760,255
1935(1) ..	212,226	534,076	48,905	795,207	203,197	514,997	47,421	765,615
1936 ..	212,326	535,856	51,541	799,723	203,222	521,366	50,920	775,508
1937 ..	211,406	542,700	53,150	807,256	202,641	527,275	52,800	782,716
1938 ..	210,941	549,825	54,975	815,741	202,447	533,875	54,700	791,022
1939 ..	211,825	558,125	56,875	826,825	203,337	541,525	56,825	801,687
1940 ..	214,415	549,550	58,850	822,815	206,015	549,025	59,450	814,490
1941 ..	217,956	525,800	60,925	804,681	209,692	554,775	61,800	826,267
1942 ..	223,585	514,750	63,400	801,735	213,687	560,125	64,025	837,837
1943 ..	224,275	499,800	64,875	788,950	216,435	563,850	66,400	846,685
1944 ..	227,842	503,725	67,450	799,017	219,803	567,825	69,150	856,778
1945(2) ..	233,228	523,848	69,858	826,934	224,019	571,830	71,931	867,780
1946(2) ..	240,256	565,652	73,823	879,731	231,420	572,703	77,545	881,668
1947(2) ..	250,417	575,925	76,175	902,517	241,395	577,925	80,800	900,120
1948(2) ..	261,578	583,050	78,375	923,003	252,303	582,375	83,850	918,528
1949(2) ..	273,270	590,700	80,450	944,420	263,098	586,975	86,625	936,698
1950(2) ..	285,129	598,050	82,550	965,729	273,942	591,525	89,750	955,217
1951 ..	291,971	600,820	85,085	977,876	281,353	595,180	93,120	969,653
1952 ..	306,383	610,580	86,400	1,003,363	293,841	603,080	95,865	992,786
1953 ..	319,214	623,090	87,865	1,030,169	305,602	614,390	98,665	1,018,657
1954 ..	331,034	633,430	88,945	1,053,409	316,621	623,650	101,230	1,041,501
1955 ..	(4)	(4)	(4)	1,076,018(3)	(4)	(4)	(4)	1,067,949(3)

(1) For these years total population was adjusted in accordance with the 1936 census results but no adjustment was made for age estimates.
(2) For these years total population was adjusted in accordance with the 1951 census results but no adjustment was made for age estimates.
The totals shown for cases (1) and (2) above do not therefore agree with revised total population figures published later.
(3) Provisional.
(4) Not yet available.

Source: Department of Statistics

TABLE 2

Estimated Distribution of Total Labour Force, 1936, 1939, and 1946 to 1955
(in thousands)

Industrial Group	1936 (1)	1939 (1)	October 1946 (2)	April 1947 (2)	April 1948 (2)	April 1949 (2)	April 1950 (2)	April 1951 (2)	April 1952 (2)	April 1953 (2)	April 1954 (2)	April 1955 (2)	October 1955
Primary	187	179	150·9	149·8	149·4	148·6	148·3	148·1	148·1	148·7	149·2	150·3	151·8
Manufacturing	} 117	131 {	165·0	171·6	175·8	178·0	182·2	185·6	186·3	187·2	194·2	198·8	196·1
Power, water, and sanitary services ..			9·3	9·2	9·3	9·7	10·1	10·4	10·5	11·5	11·6	11·8	11·9
Building and construction	37	56	49·1	49·3	51·0	51·9	54·1	53·8	57·1	61·6	66·0	69·2	70·3
Other industry:													
Transport and communication ..	48	57	67·6	69·4	71·3	73·8	74·8	73·8	77·0	77·2	77·4	77·5	78·0
Distribution and finance	96	100	105·9	108·1	110·9	112·1	114·5	117·8	120·3	122·4	126·9	130·8	131·4
Domestic and personal	63	51	42·9	43·3	43·9	44·7	44·6	44·1	43·7	44·9	45·7	45·7	45·4
Administration and professional ..	65	76	90·2	89·9	91·2	92·9	94·4	96·0	98·0	101·5	104·8	106·6	107·5
Total all industry	613	650	680·9	690·6	702·8	711·7	723·0	729·6	741·0	755·0	775·8	790·7	792·4
Armed Forces	2	3	14·1	13·1	8·2	7·6	8·9	10·8	10·9	12·1	11·8	10·5	9·6
Unemployed	57	19	·3	·1	..	·1	..	..	..	..	·1	..	..
Total labour force	672	672	695·3	703·8	711·0	719·4	731·9	740·4	751·9	767·1	787·7	801·2	802·0

(1) *Half-yearly Survey of Employment*, Department of Labour and Employment, July 1950, pages 5–9.

(2) *Labour and Employment Gazettes*, Department of Labour: February 1954, pages 55–56; August 1954, page 58; August 1955, page 58.

Source: Department of Labour

TABLE 3

Estimated Distribution of Total Labour Force by Sex, 1946 to 1955[1]
(in thousands)

—	Male	Female	Total
As at—			
1946 – 15 October ..	534	162	696
1947 – 15 April	543	161	704
1948 ,, ...	547	164	711
1949 ,, ...	553	166	719
1950 ,, ...	562	170	732
1951 ,, ...	566	174	740
1952 ,, ...	576	176	752
1953 ,, ...	589	178	767
1954 ,, ...	603	185	788
1955 ,, ...	610	191	801
1955 – 15 October ..	611	191	802

(1) Adjusted in line with 1951 census data.

Source: Department of Labour

TABLE 4

Total Vacancies in Surveyed Industries, 1946 to 1955[1]

—	Male	Female	Total
As at—			
1946 – 15 October ..	14,745	14,060	28,805
1947 – 15 April	18,224	14,771	32,995
1948 ,, ...	17,153	12,562	29,715
1949 ,, ...	16,377	12,626	29,003
1950 ,, ...	20,801	13,080	33,881
1951 ,, ...	21,404	11,392	32,796
1952 ,, ...	21,607	8,510	30,117
1953 ,, ...	14,197	6,217	20,414
1954 ,, ...	15,233	7,496	22,729
1955 ,, ...	18,983	8,545	27,528
1955 – 15 October ..	17,757	7,664	25,421

(1) Total vacancies as recorded in half-yearly surveys.

Source: Department of Labour

TABLE 5

Disengaged Persons at End of Month, 1946 to 1955

Average for Calendar Year	Male	Female	Total
1946	368	18	386
1947	83	9	92
1948	61	6	67
1949	88	4	92
1950	34	4	38
1951	29	9	38
1952	33	14	47
1953	67	18	85
1954	48	10	58
1955	44	12	56

Source: Department of Labour

TABLE 6

Average Weekly Wage Payout in Surveyed Industries, 1946 to 1955 (1)
(Week ended 15 April or 15 October)

Year	*Per Capita* £ s. d.	Year	*Per Capita* £ s. d.
1946 – October ..	6 5 10	1952 – April	10 7 10
1947 – April	6 13 3	1953 „	11 1 5
1948 „	7 7 6	1954 „	12 2 5
1949 „	7 14 8	1955 „	12 15 2
1950 „	8 4 6	1955 – October ..	13 4 0
1951 „	9 15 2		

(1) The figures shown cover males and females, including juveniles and salaried executives. Overtime and bonus earnings, etc., are included.

Source: Department of Labour

TABLE 7

Production and Exports of Butter (Including Whey Butter) and Cheese, 1933–34 to 1954–55

Production Year	Production (Dairy Factories)				Exports, June Years			
	Butter		Cheese		Butter		Cheese	
	Quantity	Value	Quantity	Value	Quantity	Value	Quantity	Value
	Cwt.(000)	£(000)	Cwt.(000)	£(000)	Cwt. (000)	£(000)	Cwt. (000)	£(000)
1933–34 ..	3,238·0	12,679	2,135·6	4,487	2,825·9	11,830	1,992·2	4,732
1934–35 ..	3,157·1	13,244	1,914·5	4,067	2,575·6	10,625	1,858·7	4,524
1935–36 ..	3,366·6	17,702	1,770·0	4,708	2,786·6	14,790	1,620·4	4,509
1936–37 ..	3,553·1	20,457	1,826·3	5,494	2,991·4	16,434	1,662·2	5,282
1937–38 ..	3,307·4	20,731	1,769·4	6,045	2,917·7	18,285	1,690·8	6,069
1938–39 ..	2,957·2	20,174	1,705·3	6,345	2,461·9	15,813	1,605·2	5,727
1939–40 ..	3,155·1	21,508	1,952·7	7,274	2,319·9	16,059	1,749·0	6,776
1940–41 ..	3,303·3	22,475	2,447·4	9,104	2,689·8	18,676	2,505·6	10,155
1941–42 ..	2,675·3	18,232	3,153·2	11,692	2,141·9	14,952	2,633·2	11,505
1942–43 ..	2,839·8	19,999	2,056·9	7,932	2,057·8	14,724	2,226·1	10,014
1943–44(1)	2,727·9	19,544	1,843·0	7,252	2,071·8	15,019	1,600·0	7,269
1944–45(1)	3,093·3	22,219	2,073·5	8,277	2,442·9	21,709	1,860·8	9,905
1945–46(1)	2,534·0	18,227	1,890·6	7,578	2,110·6	19,706	1,568·5	8,541
1946–47(1)	2,914·8	21,020	1,832·9	7,421	2,355·0	25,081	1,766·2	11,177
1947–48 ..	3,039·6	33,147	1,728·9	10,023	2,541·1	31,492	1,664·5	12,254
1948–49 ..	3,310·3	37,340	1,989·8	11,971	2,948·9	35,122	1,667·2	11,277
1949–50 ..	3,376·9	40,114	2,107·5	13,360	2,963·5	37,042	1,793·8	12,711
1950–51 ..	3,637·2	45,877	2,170·5	14,582	2,729·4	37,366	1,921·4	14,535
1951–52 ..	3,831·2	54,058	1,909·6	14,540	3,085·7	45,186	2,013·9	16,626
1952–53 ..	4,000·5	59,893	2,149·0	17,398	3,545·6	56,014	1,868·9	16,738
1953–54 ..	3,679·1	57,713	2,059·1	17,753	2,862·1	46,963	2,023·5	18,618
1954–55(2)	3,801·1(2)	59,798(2)	2,035·7(2)	17,440(2)	2,664·2	46,697	1,363·0	11,045

(1) Allowances to cover increases in manufacturing and wages costs were paid to dairy factories during these years, and these allowances have been apportioned to butter and cheese produced and included in the value figures as shown. Similar allowances to cover increased farm costs and paid to suppliers have not been so included.

(2) Provisional.

Source: Department of Statistics

TABLE 8

Value of Production in New Zealand, by Groups, 1933–34 to 1953–54

(£ million)

Production Year	Agricultural	Pastoral	Dairying, Poultry, and Bees	Total Farming Groups	Mining	Fisheries	Forestry	Factory([2])	Building and Miscellaneous	All Groups
1933–34 ..	8·7	31·7	22·5	62·9	3·5	0·4	2·0	18·6	11·0	98·4
1934–35 ..	7·9	28·0	23·0	58·9	3·8	0·4	2·6	20·7	10·3	96·7
1935–36 ..	9·2	33·8	28·8	71·8	4·0	0·4	3·0	23·2	11·4	113·8
1936–37 ..	8·8	46·3	33·3	88·4	4·0	0·5	3·6	26·7	12·7	135·9
1937–38 ..	8·6	40·1	35·1	83·8	4·2	0·6	4·1	30·0	13·1	135·8
1938–39 ..	8·3	37·5	33·3	79·1	4·4	0·6	4·0	30·5	14·7	133·3
1939–40 ..	9·6	38·8	36·3	84·7	4·9	0·6	4·4	33·5	15·4	143·5
1940–41 ..	10·3	46·3	39·3	95·9	5·1	0·6	4·5	37·1	14·4	157·6
1941–42 ..	11·4	45·9	37·9	95·2	5·4	0·6	4·5	41·2	14·8	161·7
1942–43 ..	13·3	46·9	36·6	96·8	5·3	0·6	5·0	45·2	15·5	168·4
1943–44 ..	14·4	48·1	36·2	98·7	5·7	0·7	5·3	49·4	15·9	175·7
1944–45 ..	16·4	56·3	43·3	116·0	5·8	0·7	5·4	52·0	16·4	196·3
1945–46 ..	15·9	55·0	39·8	110·7	6·0	0·9	6·1	55·6	19·0	198·3
1946–47 ..	15·9	64·9	48·4	129·2	6·4	1·0	6·6	61·7	23·1	228·0
1947–48 ..	17·4	81·1	55·9	154·4	6·3	1·1	8·7	70·8	24·4	265·7
1948–49 ..	19·6	84·4	62·7	166·7	6·9	1·2	10·5	77·0	27·8	290·1
1949–50 ..	20·8	118·0	68·9	207·7	8·2	1·4	10·9	84·5	31·1	343·8
1950–51 ..	20·8	213·0	77·4	311·2	9·4	1·4	12·8	97·4	36·8	469·0
1951–52 ..	23·5	136·8	89·5	249·8	9·3	1·5	15·5	112·3	41·4	429·8
1952–53 ..	24·4	167·5	100·3	292·2	11·0	1·8	15·5	115·9	43·0	479·4
1953–54([1]) ..	30·9	180·2	98·0	309·1	11·0	2·1	17·2	130·5	48·2	518·1

([1]) Provisional.
([2]) Excluding processing of primary products included in other groups.

NOTE.—Owing to a revision of methods for the farming group which has been carried back only to 1938–39, the figures for earlier years are not on identical bases, but general comparisons are not invalidated.

Source: Department of Statistics

TABLE 9

Index Numbers of Total Value and Volume of Production, 1933–34 to 1953–54

(Base: 1938–39 = 100)

Production Year	Farm		Factory([2])		Total (Including Other)	
	Value	Volume	Value	Volume	Value	Volume
1933–34	77	99	61	59	72	87
1934–35	72	96	68	69	71	87
1935–36	88	101	76	76	84	93
1936–37	108	104	88	90	100	99
1937–38	102	104	98	95	100	100
1938–39	100	100	100	100	100	100
1939–40	107	104	110	110	108	106
1940–41	121	115	122	114	118	112
1941–42	120	111	135	117	121	110
1942–43	122	107	148	122	126	109
1943–44	125	106	162	129	132	109
1944–45	147	115	170	132	147	114
1945–46	140	107	182	136	149	112
1946–47	163	111	202	146	171	118
1947–48	195	114	232	159	199	123
1948–49	211	118	252	167	218	130
1949–50	263	123	277	174	258	137
1950–51	393	127	319	184	352	141
1951–52	316	126	368	196	322	144
1952–53	369	132	380	196	360	147
1953–54([1]) ..	391	133	428	211	389	152

([1]) Provisional.
([2]) Excluding processing of primary products included in other groups.

Source: Department of Statistics

TABLE 10

Index Numbers of Value and Volume of Production Per Head, 1933–34 to 1953–54

Production Year	Value Per Head of Mean Population, June Years	Volume Per Head of— Mean Population, June Years	Volume Per Head of— Approximate Mean Population, Persons Aged 15–64, June Years	Volume Per Head of— Labour Force as Estimated by Department of Labour
	(Base: 1938–39 = 100)			(Base: 1946–47 = 100)
1933–34 ..	76	91	91	..
1934–35 ..	74	91	91	..
1935–36 ..	86	96	96	..
1936–37 ..	102	101	101	..
1937–38 ..	101	101	101	..
1938–39 ..	100	100	100	..
1939–40 ..	106	105	105	..
1940–41 ..	117	111	112	..
1941–42 ..	120	109	112	..
1942–43 ..	125	108	112	..
1943–44 ..	130	108	112	..
1944–45 ..	142	111	115	..
1945–46 ..	139	104	109	..
1946–47 ..	156	107	112	100
1947–48 ..	177	110	116	102
1948–49 ..	190	113	121	107
1949–50 ..	221	117	127	110
1950–51 ..	295	118	130	113
1951–52 ..	265	118	131	113
1952–53 ..	288	118	131	114
1953–54[1] ..	303	118	133	115

[1] Provisional.

Source: Department of Statistics

to be switched to more profitable lines. He said that farmers producing the goods whose price had fallen would be encouraged to switch although, pending transfer, they would receive their full cost, plus a reasonable profit, from debt-free money. Farmers would not be directed to change production, but they could not expect financial help to continue if they persisted in producing things which were not wanted.

176. We would observe that market trends overseas could not be ignored completely if the prices of all New Zealand's export products fell drastically. Although, in such circumstances, import prices would be likely to fall also, they would probably fall less than export prices if past experience can be taken as a guide. Thus, each unit of goods exported would be exchangeable for a lower volume of imports than before. The total volume of imports could be maintained for a time by drawing on our foreign exchange reserves, but if the fall in export prices persisted, it would eventually be necessary to reduce imports. Mr Young acknowledged that no administration could prevent a decline in New Zealand's standard of living if this should happen.

177. Mr Young was questioned on the danger of inflationary pressure arising as a result of maintaining domestic incomes while the volume or value of imports fell off. He replied that this could be avoided by *"voluntary price regulation"*, by the use of any surplus reserves of foreign exchange, by some switch of production from capital to consumer goods, and by avoiding an over-issue of money. Towards the end of his evidence, Mr Young said that if the gap was not sufficient to justify financing subsidies out of debt-free money, he would *"tax or stop some other work in favour of this particular purpose the money is required for"*. The statement indicates a notable departure from the fundamental principles of the Association's original case, and the adoption of a view much more in line with current financial opinion.

XIII. Social Credit, International Trade, and Control by the State

178. Both Miss King and Mr Young stated that import selection would be an essential element of Social Credit policy. It would be necessary to prevent excessive spending on imports and to ensure that, if overseas funds were scarce, those imports which were least essential to the New Zealand economy would be excluded.

179. We would make two comments on the foregoing statement. First, a system of import selection would not be sufficient to safeguard our foreign exchange reserves if the money supply were excessively inflated; for such inflation would mean that costs in the export industries would be driven up in relation to prices received for exports and these industries would become less attractive in relation to those producing predominantly for the home market. Unless exports were subsidised, the tendency would ultimately be for the volume of exports to decline, thus reducing our earnings of foreign exchange. At the same time, the demand for foreign exchange would be increased as a result of domestic inflation and the difficulty of administering the controls would be considerably increased.

180. Secondly, this is another of those direct controls by Government to which the Social Credit Association and the Social Credit Political League have declared themselves opposed in principle. Mr Young was unable to point to any control in existence today which Social Credit

could abolish. In fact, his evidence showed that control by the State would be expanded considerably. Not only would we revert to a system of detailed import selection and exchange control, but we would also have comprehensive price regulation and a much stricter control of bank advances; probably control of building, interest rates, and rents; and possibly, in an emergency, rationing plus the freezing of certain money holdings. If the views of those with more grandiose ideas than the Association about issuing debt-free money were accepted by the Government, the country, in our opinion, would soon have to be subjected to even more rigid controls, conceivably even including the direction of labour, in order to hold down costs and prices and preserve a measure of equity in the distribution of the available goods and services.

181. We do not intend in this report to discuss the ultimate objectives of Social Credit but if, as Miss King said, two of the long-term aims of social crediters are the replacement of wages and salaries by a universal national dividend and the abolition of interest, we cannot see how at the same time they could preserve a system of private ownership and private enterprise. The two former objectives are completely incompatible with the third.

XIV. Summary and Conclusion

182. It was apparent from the remarks of counsel for the Social Credit Association in opening his case that the version of Social Credit put before the Commission by the Association was designed to avoid some of the more extravagant features of that put to the electors of New Zealand by the Social Credit Political League in 1954. It was also more cautious than that advanced by most of the other witnesses who appeared before the Commission and who claimed to be social crediters. Even in its original submissions the Association gave us no assurances of the speedy abolition of debt and taxation or of the practicability of the institution of a universal national dividend financed from debt-free money. In the early stages, the representatives of the Association maintained a firm conviction that there was a large gap to be filled between purchasing power and prices, which would justify an issue of debt-free money by the Government to enable taxation to be reduced, subsidies to be paid to retailers, social security benefits to be increased, and non-commercial works to be financed without an increase in the public debt. But no attempt was made to measure the extent of the alleged gap, and under examination Mr Young admitted that all the previous estimates which had been made were full of serious errors. There was no readiness to assert that it was safe to issue £90 million or £190 million of debt-free money at the present time and in fact, in evidence, Mr Young said that it would be a mistake to promise any reduction of taxation or increase in benefits.

183. The original convictions of the Association's witnesses about the gap and its size obviously weakened as our hearings proceeded. Major Douglas's "A + B theorem" upon which most Social Credit literature in the past has relied to prove conclusively the extent of the alleged chronic gap, and which still formed the basis of the representations of some of the other Social Credit witnesses, is now regarded by the Association as being *"of academic interest"* only. In their submissions it was made clear that the belief of the Association's representatives in the existence of a

chronic gap rested primarily on *"evidence from experience"*, namely, the occurrence of depressions in the past and the growth of debt in New Zealand since 1936. But under examination their faith in this evidence practically disappeared; for instance, towards the end of our hearings, Mr Jordan admitted that *"increases in debts, public and private, are neither a measure of the 'gap', nor conclusive proof of it"*. Indeed, he went so far as to say that the Association does *"not postulate a chronic shortage of purchasing power"* and asked us for a recommendation that *"the war against inflation be carried on"*.

184. The only positive suggestion which the Association recommended to us for immediate application was that a National Credit Authority should be set up and a national survey made to ascertain, *inter alia*, whether or not a gap existed. It was clearly indicated that the soundness of the remedy which they proposed for later application – the issue of debt-free money to finance various items of Government expenditure – depended on the demonstration of a gap. Miss King and Mr Young agreed that, if the case for the gap failed, the case for the application of Social Credit failed.

185. No Social Credit witness produced evidence to satisfy us of the existence of a gap, chronic or temporary, at the present time. In fact, as indicated above, the Social Credit Association appeared to have realised by the end of our hearings that New Zealand is currently suffering from an excess, not from a shortage of spending power. In such circumstances, there is nothing to warrant the adoption of Social Credit's financial proposals. We are convinced that implementation of the proposition of some witnesses that all Government expenditure should be financed with debt-free money would result in disastrous inflation.

186. The main submissions made by counsel for the Social Credit Association in his final address were that it was necessary to have a national survey and to set up an authority *"to watch carefully inflation and deflation and to take the appropriate steps in the case of imbalance"*. These recommendations are discussed in other sections of our report dealing with research and statistics and with the co-ordination of policy. The principal surviving variation in the Association's case from generally accepted financial opinion was that, if there were justification in the future for an issue of new money, this should preferably be made debt free to the Government to pass on to consumers or to finance non-commercial works. We do not favour this proposal. To believe that it would reduce costs, prices, and total indebtedness is illusory. Moreover, it would give a completely false picture of the real cost of Government works and would be a potent inducement to extravagance in the granting of benefits and tax concessions.

187. The Association's final views were substantially different from the submissions which the Association originally presented, and from the version of Social Credit advanced by most other witnesses, which followed more closely the traditional doctrine of a chronic gap. It is not surprising that this doctrine should have flourished during a depression. In a period when large numbers of people are unemployed, wages and prices are falling, and considerable stocks of goods are unsold, there is every reason to believe that placing more purchasing power in the hands of the people will improve the operation of the economic machine. But, as changes in the Association's attitude show, it is impossible to sustain

a contention that there has been a general shortage of purchasing power during a period when there has been virtually no unemployment, a very large number of employment vacancies, recurrent shortages of goods and services, and continually rising prices.

188. Perhaps the continuing belief of many witnesses that the issue of large quantities of new money would be beneficial in such a period rests mainly on a confusion between what is good for the individual and what is good for the community as a whole. We know that if, as individuals, we won a lottery or received a substantial increase in pay, we could buy more of what we want. But if an issue of debt-free money for tax reductions or increased benefits gave us all the equivalent of a lottery prize or a pay increase, no-one would be better off at a time when labour and resources were fully employed. The issue of debt-free money in such circumstances would not enable any more goods or services in the aggregate to be provided.

189. The additional money would not remain unspent; nor would it be cancelled out of existence as soon as it was spent as some witnesses contended. We would merely have much more money chasing a relatively constant supply of goods and services. Inevitably prices would be driven up by extra competition for the things which were available for sale. If the tax concessions and increased benefits were repeated in subsequent years, necessitating further issues of debt-free money, the country would be engulfed in a rapid inflation, bringing in its train economic, political, and social problems of a magnitude and severity which it is to be hoped New Zealand will never be required to face.

NOTE 1 TO APPENDIX E

Points of Difference Between Witnesses for the New Zealand Social Credit Association and the Book How Social Credit Works *Compiled by Mr Wilfrid B. Owen*

(Reference paragraph 6 of Appendix E)

190. In view of the difficulty which the Commission found in reconciling the views expressed by witnesses for the Social Credit Association with published Social Credit literature – in particular with the book *How Social Credit Works* compiled by Mr Wilfrid B. Owen, President of the New Zealand Social Credit Political League – Mr R. G. Young, Vice-President of the League, agreed, in response to a request from the Commission, to state concisely the points of difference. These are set out herewith.

191. *How Social Credit Works,* page 29:

The Social Credit idea is that, under modern conditions, complete employment in Industry is neither possible nor desirable; that the national dividend must progressively replace the wage and salary; that credit must be issued free to consumers to bridge the gap between purchasing power and prices, and that this Consumer Credit shall be the controlling factor in Distribution.

Mr Young:

Our comment is that that is not practicable in New Zealand, that full employment is necessary and desirable in this country, and that we see nothing in the foreseeable future that the national dividend would replace the wage and salary systems.

192. *How Social Credit Works,* page 31:

Our survey of the principles, theories and policies governing Finance as the agent of Distribution must convince us why they are ineffective in distributing the goods and services provided by Industry with the least trouble to the community. It reveals that the true purpose of an economic system, which is to deliver goods and services to the limit of productive capacity, or the limit of consumptive capacity, whichever occurs first, has been perverted entirely to serve the interests of the Financial system.

Mr Young:

You will remember I disavowed . . . it had been deliberately perverted to that idea.

193. *How Social Credit Works,* page 45:

In New Zealand the Central Bank is the Reserve Bank; that is, the Central Bank belongs to the people and should function for their benefit. To-day it merely functions for the benefit of the private banks and by its control of currency, based, or supposedly based, on a gold and sterling basis, regulates the financial credit of New Zealand.

Mr Young:

We disagree [with the statement that "it merely functions for the benefit of the private banks".]

194. *How Social Credit Works,* page 53:

Discusses the A + B theorem at some length and in some detail. Mr Young agreed that the computation of the gap in the example given was incorrect. He also agreed that the example had no regard to the continuity of production and the continuity of payments out in the course of production.

195. *How Social Credit Works,* page 55, the heading:

"Prices always greater than incomes".

Mr Young:

It should be . . . nearly always greater than incomes.

196. *How Social Credit Works,* page 58:

A word or two about Savings. If Industry distributes £1,000,000 in wages, salaries and dividends, and the recipients save £100,000, it should be evident that goods to this value remain unsold. If this sum is then invested in production it ceases to be available as purchasing power, but creates a fresh lot of consumable goods.

Mr Young:

We are quite willing to concede that money spent in investment is purchasing power for capital goods and so forth. [Money spent on investment] . . . is purchasing power at the time it is spent.

197. *How Social Credit Works,* page 62:

Like most professions and industries the banking system of U.S.A. (and elsewhere) have their "trade journals". The following quotations taken from the *United States Bankers' Magazine* dated 26th August, 1924, would seem to indicate that the decision for a slump was certainly made about this time. The following can fairly be claimed to be an instruction to all banks:

"Capital must protect itself in every possible manner by combination and legislation. Debts must be collected, bonds and mortgages must be foreclosed as rapidly as possible. When through a process of law the common people lose their homes, they will become more docile and more easily governed through the influence of the strong arm of government, applied by a Central power of wealth under control of leading financiers. This truth is well known among our principal men now engaged in forming an imperialism of Capital to govern the world."

Question:

You disown that [the above quotation]?

Mr Young:

Yes.

198. *How Social Credit Works,* page 68:

. . . the general principles on which the necessary reform is based have been laid down by Douglas as follows:

1. That the cash credits of the population of any country shall at any moment be collectively equal to the collective cash price for consumable goods for sale in that country, and such cash credits shall be cancelled on the purchase of goods for consumption.
2. That the credits required to finance production be supplied, not from savings, but be new credits relating to new production.
3. That the distribution of cash credits to individuals shall be progressively less dependent upon employment. That is to say, that the National Dividend shall progressively displace the wage and salary.

Mr Young:

This at the present time is under consideration by the Dominion Executive of the Social Credit Political League for a re-statement. We are not happy with those three.

. . . it suggests arbitrarily that all future production should be financed from new bank credit, not from savings. We think people should have the right to use their savings if they so desire.

There is criticism within our own ranks to some extent that if you took it literally on its face value as actually stated there it would prohibit a man from using his savings if he wished to, which we think is unreasonable.

Question:

At the moment you do not accept them as the three basic principles for reform?

Mr Young:

No, sir. They are being re-stated.

199. *How Social Credit Works,* page 71:

(a) The second principle is: "That the Credits required to finance production shall be supplied, not from savings, but be new Credits relating to new production, and shall be recalled only in the ratio of general depreciation to general appreciation."

As we have shown, the problem of insufficient purchasing power is intensified by the question of savings. These, being a portion of A payments direct to individuals, should help to take goods off the market, but do not.

(b) There is no economic virtue whatsoever in savings, and the orthodox ideas that Capital is dependent on savings are either fallacious or rendered ineffective by the increasing use of Bank Credit. Savings prevent goods valued at a like amount from being sold, and when such savings are reinvested in production they create a new series of costs without generating any fresh purchasing power.

Mr Young:

(a) This is also being reconsidered by the League.

(b) We do not accept that [there is no economic virtue in savings.]

As I say it was done in a hurry and he took this from Stone's book and there was not the close attention given to it that there should have been. It is a warning to us in future to be much more careful in these matters.

200. *How Social Credit Works,* page 71:

The third principle is: "That the distribution of Cash Credits to individuals shall be progressively less dependent upon employment. That is to say, that the dividend shall progressively displace the wage and salary, as productive capacity increases per man hour."

Under the existing system employment is the only means of obtaining purchasing power, and this principle recognises the necessity of providing some form of income other than wages and salaries as machines progressively displace men from industry.

Mr Young:

We think so far as New Zealand is concerned that it is not within the foreseeable future.

201. *How Social Credit Works,* page 72:

For a hundred years the efforts of the scientist and inventor have been devoted to finding new and better processes, bigger and faster labour-saving machines. So successful have they been that it has been estimated that a period of from two to four hours' labour a week for men during 25 years only of their lives is sufficient to provide the total population with a very high standard of living and with complete economic security for all.

Mr Young:

You remember there was a question about these figures. We do not think that those are applicable to New Zealand at all.

202. *How Social Credit Works,* page 73:

When the shackles of the Monopoly of Credit are removed this idea of compulsory work will lose all relation to reality, because it will be impossible to adjust full scale employment to an increasingly mechanised industry. The national dividend is inevitable in a world of progress.

Mr Young:

That is in the distant future. A long way off.

Question:

Some time that you and I will never see?

Mr Young:

I think so.

203. *How Social Credit Works,* page 80:

This dividend, as by the illustrative figures given in our previous lecture, would be of the same total amount as the total of the retail discount, and would be paid by the National Credit Authority direct to individuals either through the Post Office, as pensions are now paid, or direct by cheques.

We do not doubt that both the discount schemes could be put into operation very easily. Only experience and a period, perhaps, of trial and error would determine the easiest and most effective methods of administration.

We think a combination of the two would be necessary. For instance, services such as transport, amusements, and any form of business where tickets are issued, and retail shops selling fruit and perishable goods, where quantities and qualities depend on indeterminate factors, would probably be better served by the second alternative. For the great bulk of consumable goods probably the first alternative is the better, but experience only will determine this.

Mr Young:

The whole page is a matter for consideration and we do not think that any useful purpose would be served, as far as New Zealand conditions are concerned, in discussing the thing.

204. *How Social Credit Works,* page 93:

THE PHILOSOPHY OF SOCIAL CREDIT

During the early days of the Social Credit Movement lecturers laid great stress on the A and B theorem, the Just Price regulating factor and other technical aspects of the New Economics.

Perhaps they overdid this, but it provided a sound and necessary basis of knowledge. In more recent years they have gone to the other extreme and have concentrated on bank-created credit, debt and taxation.

We have long held that the successful teaching of Social Credit as a practical reform must include both these aspects; they are complementary to each other.

But Social Credit is much more than a reform and a change in the financial system; it is a PHILOSOPHY, and experience has taught also that we have not given sufficient consideration at any time to this vital aspect of our teaching.

When we go out to preach Social Credit we find there are two powerful groups opposed to us – one representing conservatism and the vested interests that we may term the Sound Finance group; the other representing the mass of wage and salary earners that we may term the Socialist group.

These groups oppose one another, but they both agree to oppose Social Credit. Each stands for a definite Social and Economic system, and so does the Social Credit group.

Now Douglas, in one of his most important and valuable utterances, has stated that a Social and Economic system represents "the policy of a philosophy," and he defines "policy" in this connection as "action consciously directed towards a given objective."

If we look at the philosophy of Sound Finance we must recognise that the policy directed to make it effective develops into a system akin to Fascism. If we look at the philosophy of Socialism we must recognise that the policy directed to make it effective develops into Communism.

Both of these policies lead to a system of centralised control in the hands of a few – one through finance, the other through bureaucracy.

Both tend to destroy individual initiative – one by debt and taxation, the other by the elimination of private enterprise.

Both represent the will-to-power – one by money control, the other by political and social organisation.

Both believe in policy imposed from above – one by law and necessity, the other by force.

Both suppress individual freedom – one by economic compulsion, the other by economic regimentation.

Both have false ideals of an economic system –, one as a means to make profits, the other as a means to provide employment.

Both believe in the Work State – one because it objects to leisure, the other because it conceives work as the only economic security.

Both believe that men exist to serve a system – one because it worships the supremacy of finance, the other because it worships the State as an abstraction.

As Social Crediters we disavow both these philosophies and the policies and systems that grow out of them. They are the enemies of progress and liberty and the negation of the free spirit of man. The philosophy of Social Credit is entirely opposed to them.

Social Credit believes in decentralised control, with the foundations of society laid on the complete independence of the individual. It believes that policy should come from the community through building up from the Individual, not down from the State.

It believes that systems are made for men and not men for systems.

It believes that the future of the world lies in co-operation, but only in the co-operation of reasoned assent, not in the forced co-operation of regimentation. It believes that the economic activity is simply a functional activity of men and women in the world and that progress is most rapid and effective through the free expansion of self-development.

It believes that science and invention must not be used to enslave men, but to free them from unnecessary work and so give them leisure and the chance of self-development.

It believes that men have "an inalienable right to life, liberty and the pursuit of happiness."

It believes that the system under which men live must represent truth and reality and not lies and falsity.

It believes that this system should develop a community of diversified and independent individuals and not a mass of standardised and servile ones.

It believes that this system should give not only security, but freedom, and that freedom, security and peace are one and indivisible.

It believes that every individual is a shareholder in the common heritage of Civilisation and that the wealth that flows from this heritage is part of his birthright.

It believes that absolute economic security is the first and basic requirement of a New Civilisation in which every man will be entitled "to sit under his own vine and under his own figtree and none shall make him afraid".

Unless we believe in this philosophy of Social Credit it is useless to bother about anything else. If we do believe in it then we must advocate the principles and policies to make it effective.

Mr Young:

That is of academic interest, we feel, at the present time.

205. *How Social Credit Works,* page 92:

6. What is the JUST PRICE? The Just Price of an article is the price representing its true cost. It is determined by the ratio which total production of all descriptions bears to total consumption and depreciation. The Just Price is also called the COMPENSATED PRICE.

7. What is the JUST PRICE FORMULA? This is the mathematical formula used to determine the just price of an article in relation to its financial cost . . . The "Just Price" of any article is the cost of the goods actually CONSUMED in its production. "The Cost of production is Consumption."

Mr Young:

. . . that argument is useless . . . It is of academic interest.

NOTE 2 TO APPENDIX E

Computations of the Social Credit "Gap" Published in Social Credit Literature

(Reference paragraph 82 of Appendix E)

206. Three computations of the "Gap" published in Social Credit literature were discussed by the Commission with Mr Young, a witness for the New Zealand Social Credit Association, and with the Government Statistician, in some detail. These computations were:

(a) The gap between incomes received and national production in 1950–51, published in the *New Zealand Social Crediter,* 15 March 1955, pages 6 and 7.

(b) The statement of the gap for 1951–52 in *Social Credit's Solution* (pages not numbered), a pamphlet published by the New Zealand Social Credit Political League in 1954.

(c) *"Production and Income, 1950–51",* appearing at pages 8 and 9 of *Social Credit is the Key,* by G. Hinton Knowles, in collaboration with F. D. Danks.

Results of the examination in respect of these three computations are summarised in the following paragraphs.

The gap between incomes received and national production, 1950–51, from the *New Zealand Social Crediter*

207. This compilation sets out to compare *"money incomes of New Zealanders obtained through the production of consumer goods and services"* in 1950–51 with *"the total retail prices of such consumer goods and services".*

208. The compilation as published was as follows:

VALUE OF PRODUCTION

		£
In the year ended 31/3/51 (see 1951–52 Year Book, page 961) ..		473,200,000
This figure represents value at point of production. Nothing added to cover costs of distribution. Services not included.		
DEDUCT EXPORTS (Calendar year 1950), (i.e. goods produced in N.Z. but not placed on N.Z. market)	£	
F.O.B. Value	183,700,000	
Less 25 per cent	45,900,000	
		137,800,000
		335,400,000

This deduction of 25 per cent is made to reduce F.O.B. value to value at point of production.

ADD IMPORTS (Calendar year 1950)	158,000,000
C.D.V. and 10 per cent added only.	
	493,400,000
ON COST	
At least 50 per cent must be added to cover distribution charges, etc.	246,700,000
Gross National Production at Retail Prices	£740,100,000

NOTE.—O.E.N.I. = Official Estimates of National Income.
I.I.T.S. = Income and Income Tax Statistics.
(Reports published by Census and Statistics Department, Wellington).

INCOME OF NEW ZEALANDERS

Available for purchase of National Production

(See Report on the Official Estimates of National Income, 1954)

YEAR ENDED 31/3/1951	£
O.E.N.I. Salaries and Wages	279,000,000
O.E.N.I. Armed Forces	6,000,000
O.E.N.I. S.S. Benefits and Pensions	48,000,000
O.E.N.I. Other Personal Income	193,000,000
I.I.T.S. Company Dividends	18,000,000
	544,000,000
O.E.N.I. and I.I.T.S. Less Direct Taxes (excluding direct taxes on Companies, as only dividends have been included above)	75,000,000
	£469,000,000

	£
Production Value (see above)	740,100,000
Private Net Income	469,000,000
Apparent "Gap"	£271,100,000

There are two major amendments to these figures which must be made before we can approximate the true "Gap". What portion of the Gross National Production is Capital Goods production and which theoretically does not make a demand on personal income? Of the total personal income computed for the year, what is the figure for transferred incomes? We have already made one deduction for transferred income – direct tax – but no deduction has been made of other transferred income, such as fees paid to doctors, etc.

Allowing the sum of £171,100,000 for the value of capital goods and £100,000,000 for transferred incomes, the estimated true "Gap" is as follows:

	£
Apparent Gap	271,100,000
Add transferred incomes (estimated)	100,000,000
	371,100,000
Deduct value of capital goods (estimated)	171,100,000
Estimated True Gap	£200,000,000

209. We would remark that direct compilation of incomes earned in production of consumer goods would be a most difficult, if not an impossible, statistical operation because it is the "end-use" that determines whether goods or services form part of capital goods or consumer goods. To take a simple example, timber may be used for repairs (consumer services) or for new construction (capital). How then are wages paid in the bush or in the timber mill to be apportioned? In the above table the compiler avoided this difficulty by including all salaries and wages and

other incomes, whether earned in production of capital goods or of consumer goods and services.

210. Notwithstanding inclusion of all such incomes, a subtraction of £171·1 million has been made from the figure for total production to obtain an estimated figure for the production of consumer goods and services, before comparing this with total incomes. This is, of course, a serious error. Mr Young agreed that if a deduction of this nature had been made on the production side without a corresponding deduction from incomes it *"would be quite a serious error of principle"*. The statement also omits Government and local authority expenditure on consumer goods.

211. No evidence was forthcoming to support the accuracy of the subtraction of 25 per cent as representing the reduction of the f.o.b. values of exports to the *"value at point of production"*. Nor was Mr Young able to substantiate the addition of 50 per cent as *"on cost"*. He agreed that the accuracy of the results of the table was dependent on the correctness of these percentages.

212. The Government Statistician said of this estimate that a statistician *"would have to disown it . . ."*. He also commented that the difference between the two sides of the statement was due to errors in compilation. Although the above table is admittedly an improvement on the other compilations discussed in this Appendix, we are satisfied from the evidence of Mr Young and of the Government Statistician that it is of no value as evidence of a gap between purchasing power and prices.

Computation of the gap for 1951–52 in *Social Credit's Solution*

213. This statement of the gap reads:

	£
Total price of all goods produced for sale in New Zealand ..	670,500,000
Total incomes earned by the people	477,000,000
Shortage of money or income	£193,500,000

214. From the evidence it appears to us that the above table was computed approximately as follows:

		£(million)
VALUE OF PRODUCTION 1951–52		426·3
DEDUCT EXPORTS (Calendar Year 1951):		
F.O.B.	248·1	
Less 25%	62·0	
		186·1
		240·2
ADD IMPORTS (Calendar Year 1951):		
C.D.V. + 10%		206·5
		446·7
ADD "On Cost" 50%		223·4
Value of Goods at Retail Prices		£670·1
INCOMES		
Salaries and wages for 1950–51		275·3
Company and other incomes for 1949–50		201·5
		£476·8

215. It appears that the total income of £476·8 million was computed by multiplying the social security charge receipts for 1950–51 – £35·766 million – by 13$\frac{1}{3}$. Such receipts represent tax on salary and wages for 1950–51 and company and other incomes for 1949–50, at 1s. 6d. in the pound.

216. The computation of goods produced is subject to the same criticisms regarding the addition of arbitrary percentages as the table published in the *New Zealand Social Crediter* of March 1955. The remarkable thing about the statement published in *Social Credit's Solution* is that, as shown above, it compares an assessment of production for 1951–52 with salaries and wage incomes for 1950–51 plus company and other incomes for 1949–50. Such a comparison is quite worthless.

"Production and Income, 1950–51" in *Social Credit is the Key*

217. This computation of the gap for 1950–51 is as follows:

PRODUCTION AND INCOME, 1950–51

Does our financial system distribute sufficient purchasing power by way of wages, salaries, dividends and profits to pay the price of what is produced at any given period?

FIGURES FROM 1952 YEAR BOOK

		£
Total Production (page 961)		473,000,000
Material production only. Value at point of production. No amount added for transport or distribution through wholesaler or retailer. No valuation of services included.		
Deduct Exports (page 229)	£	
F.O.B. Value	184,000,000	
Less 25 per cent.	46,000,000	
		138,000,000
		335,000,000
This percentage deduction is necessary, as in all total production primary products are valued "on the hoof".		
Add Imports (page 251)		
C.D.V. and 10 per cent. only		158,000,000
		493,000,000
Add on Cost		
As nothing has been added to above figures for sales tax, excise or customs duties, transport, wholesale and retail distribution charges, then at least 40 per cent. must be added to find the cost to the consumer:		
40 per cent of £493,000,000 equals		197,000,000
Total Price Charges		690,000,000
Purchasing Power		
Wages, salaries, dividends, profits, other income, Social Security Tax gives a reasonably accurate figure for this item		477,000,000
Non-taxed income, including evasion (say)		23,000,000
		£500,000,000
Total Price Charges, as above		690,000,000
Nett Cash Income		500,000,000
		£190,000,000

It is obvious that £500,000,000 of income cannot liquidate £690,000,000 of price charges. There may be differences of opinion on the details given above and the percentages used, but it is submitted that there is clear proof in the above statement that costs are generated at a greater rate than incomes.

218. The above computation of production is similar to that published in *Social Credit's Solution* and is subject to similar limitations except that in this case *"on cost"* has been added at 40 per cent instead of 50 per cent. Again a mistake in income has been made by including wages and salaries for 1950–51 with company and other income for 1949–50 as total income for 1950–51. Mr Young admitted that this computation also was not competent statistical work.

219. Mr Young did not appear to have a competent understanding of these computations. He was under the impression that the gaps measured were before incomes received from public works or other supplements to income had been included. However, under cross-examination, he admitted that total incomes including incomes from public works had been included in the computations. Mr Young said, *"I would say as a practical observation round the country, for anyone to suggest there was a net gap of that sort, he was a dreamer"*.

220. In his evidence, the Government Statistician confirmed the erroneous nature of the three compilations referred to above. Furthermore, Mr Jordan disowned them and said, *"I should say truly that these statements have never been received as correct by the general body of social crediters, nor by the many who have always urged and have objected to these statements from time to time, on the ground that the compilers haven't the necessary information, and on the further ground that the state of full employment and the state of high prices under which our economy has existed during the past few years, have indicated that there could not be anything like the amount of gap that has been estimated"*.

221. We are satisfied that the statistical computations of the gap printed in publications of the New Zealand Social Credit Association and of the New Zealand Social Credit Political League are faulty statistical work having no value as evidence for or against the existence of a shortage of purchasing power and certainly providing no sound basis for any issues of debt-free money.

222. In answer to a request of the Commission the Government Statistician supplied the following statement setting out aggregate incomes and production over a period of years 1950–51 to 1954–55:

GOODS AND SERVICES COMPARED WITH INCOMES

(£million)

—	1950–51	1951–52	1952–53	1953–54	1954–55
Goods and Services					
1. Gross National Product at market prices	696	722	754	834	927
2. Less imputed rental value of owner occupied houses	−14	−15	−16	−19	−21
3. Export surplus (−) or deficit (+) ..	−30	+30	+5	−28	+39
4. Total goods and services available at market prices	652	737	743	787	945

GOODS AND SERVICES COMPARED WITH INCOMES—*continued*

(£million)

—	1950–51	1951–52	1952–53	1953–54	1954–55
Incomes					
5. Wages, salaries, interest, dividends and profits on which social security tax is paid:					
(a) Earned in current production of goods and services	580	589	621	689	755
(b) Interest paid to holders of the public debt domiciled in New Zealand	17	17	17	18	20
	597	606	638	707	775
6. From which Government has levied in taxation (including local authorities)	−113	−142	−146	−154	−168
7. Leaving in the hands of the public out of current incomes	484	464	492	553	607
8. But the Government has returned to the public tax free social security payments (including pensions)	48	54	54	58	61
9. In addition there are depreciation allowances on which no tax has been paid (therefore not included in (5) above)	39	43	46	50	57
10. Total incomes in the hands of the public to purchase goods and services ..	571	561	592	661	725
But the Government (General and Local Authority) spends the income it collects from the public. This amounts to:					
11. Direct taxation (deducted from private purchasing power (see (6) above) ..	113	142	146	154	168
12. Indirect taxation included in the prices of goods and services (4) above ..	56	71	67	68	82
Less subsidies on consumer goods ..	−9	−16	−15	−16	−13
Making	47	55	52	52	69
13. Profits from Government Departments trading and non-trading	16	19	18	24	27
14. Gross Government Income	176	216	216	230	264
15. The Government has returned to the public taxfree social security benefits (which it therefore cannot spend itself) (see (8) above)	−48	−54	−54	−58	−61
16. Interest on the public debt domiciled in New Zealand (included in (5) above) is also returned to the public so Government cannot spend it ..	−17	−17	−17	−18	−20
17. Net Government income from which it can purchase goods (e.g., materials for public works included in (4) above) and services (e.g., Civil servants' services included in (4) above)	111	145	145	154	183
18. Total incomes:					
In hands of – Public (10 above) ..	571	561	592	661	725
In hands of – Government (17 above)	111	145	145	154	183
Total Incomes	682	706	737	815	908

GOODS AND SERVICES COMPARED WITH INCOMES—*continued*

(£million)

—	1950–51	1951–52	1952–53	1953–54	1954–55
19. Decrease in overseas assets (+) or additions to overseas assets (−) ..	−30	+30	+5	−28	+39
20. Total (18 + 19)	652	736	742	787	947
21. Total value of goods and services available (4 above)	652	737	743	787	945
Rounding of figures causes these differences	..	−1	−1	..	+2

223. The above statement shows an equality between goods and services becoming available at market prices and total incomes (after allowing for changes in overseas assets). (See comment in paragraph 60 of this Appendix.) The Government statistician agreed that his tabulation was *"an effective statistical refutation of any contention that there has been a chronic shortage of purchasing power in the hands of the people relative to the price of total production in those years"*. He also said that if statements on the same basis were prepared for other years the results would be similar.

224. The Government Statistician's statement does not prove that purchasing power is always sufficient to make the best use of the country's resources without generating inflation. It does, however, prove that there is no chronic defect in the industrial and financial system which must lead to a shortage of purchasing power and which would therefore justify issues of new money as a regular feature of budgetary policy.

Appendix F

SUBMISSION OF Mr H. J. KELLIHER AND THE MIRROR PUBLISHING COMPANY LIMITED

TABLE OF CONTENTS

I. Introduction

1. Mr H. J. Kelliher, in association with The Mirror Publishing Company Limited, made lengthy submissions to the Commission through his witness, Mr W. S. Otto. Mr Kelliher himself did not appear at the hearings, but was represented by counsel, Dr O. C. Mazengarb, Q.C. These submissions, which were obviously the result of much careful thought and preparation, comprised six parts dealing with the following subjects:

(a) Existing banking and economic system.
(b) Overseas trade – wages – fiscal policy – criticism of present system.
(c) Recommendations for reform of existing banking system.
(d) Other recommendations for reform.
(e) Summary of proposals for reform.
(f) A recommendation that New Zealand should not join the International Monetary Fund.

2. The hearing of Mr Otto's evidence and his examination and the addresses of counsel occupied a period of nearly twelve days. Wherever we ascribe matter to Mr Kelliher in this report we are referring to the preliminary documents placed before the Commission, to the prepared submissions, and to the remarks of Mr Kelliher's counsel. Where Mr Otto is mentioned we refer to his statements under examination, to his written replies to questions put to him during the hearings, and to documents presented in amplification of his evidence.

3. In general, these submissions comprised an analysis of the existing economic system with special emphasis on the banking system, a statement of the weaknesses which Mr Kelliher regarded as inherent in the economic and banking systems, and suggestions for curing such weaknesses.

4. Mr Kelliher asserted that the following defects were inherent in the existing banking system:

(a) The lending and investment operations of the trading banks were expanded in times of prosperity in the ordinary course of their business, and contracted in less prosperous times.
(b) These operations resulted in the creation and destruction of money, that is, an expansion and contraction in the volume of money.
(c) This expansion and contraction of the volume of money was the major cause of the rise and fall in prices.

Mr Kelliher claimed that the Loanable Funds Scheme would remedy these defects and achieve stability in the volume of money, and that the Loanable Funds Scheme in conjunction with certain associated proposals would ensure substantial stability in prices.

Volume of Money

5. In the course of his submissions Mr Kelliher gave a number of examples of the operation of the Loanable Funds Scheme, from which it is apparent that he attached the greatest importance to the maintenance of a constant or stable volume of money.

6. The volume of money, as defined by the Reserve Bank of New Zealand and accepted and used by Mr Kelliher in his analysis of the existing banking system, comprises the following:

(a) Coin in circulation.
(b) Notes in circulation.
(c) Credit balances of customers in their current accounts at trading banks (demand deposits).
(d) Credit balances of Government and marketing accounts at the Reserve Bank.

7. The volume of money, and especially the volume of demand deposits held by the public at the trading banks, is affected from time to time by certain banking transactions, e.g., an increase in total trading-bank advances may, but does not always, result in an increase in demand deposits and, consequently, in the volume of money. On the other hand, a net reduction in bank advances originating from free deposits would reduce the volume of money. A purchase of investments by a trading bank may also result in an increase in demand deposits and, consequently, in the volume of money. The sale of investments by a trading bank may be expected to have the reverse effect. The effect of transactions such as the above on the volume of money is illustrated hereunder:

		Volume of Money (£million)
Suppose the volume of money is		312·6
Increase in trading-bank advances of £10 million might cause customers' demand deposits to rise by	(+)	10·0
A net reduction in trading-bank advances of £5 million might reduce demand deposits by ..	(−)	5·0
The purchase by trading banks of investments costing £3 million might increase demand deposits by ..	(+)	3·0
The sale of investments for £2 million might reduce demand deposits by	(−)	2·0
Volume of money after above transactions ..		£318·6

8. All increases in advances do not necessarily cause corresponding increases in deposits. An advance on overdraft by an individual bank may result in a corresponding reduction in advances made by the same or by another bank; in that case, the volume of money as defined by the Reserve Bank would not be affected. Similarly, an advance used by a customer to purchase overseas exchange would not affect the total of free deposits and, consequently, would not affect the volume of money.

Creation of Credit

9. Terms such as "creation of money" or "creation of credit", as applied to trading-bank transactions, are misleading if they give the impression that the trading banks can create unlimited credit. This is far from true. The witnesses for the banks agreed that the trading banks do create money in the course of their lending operations. We believe that it is more nearly correct to say that the creation of new and additional money may, and in fact often does, occur as a consequence of lending by the banks rather than to say, as Mr Kelliher did, that the banks *"create the money they lend"*. When a trading bank makes

advances it may well lose an equivalent, or nearly equivalent, sum in bankers' cash or in overseas funds, and it must conduct its business within these limits. In addition, the lending operations of trading banks are subject to control by the Reserve Bank which, by the operation of the reserve ratio system, freezes a proportion of the balances held by the trading banks at the Reserve Bank. The extent of credit creation by the trading banks, therefore, is subject to important limitations and safeguards.

Views of Economists on Changes in the Volume of Money

10. As mentioned previously, Mr Kelliher, in his submissions, attached the greatest importance to changes in the volume of money as causes of price movements. This view is not generally accepted by economic authorities. Geoffrey Crowther, in his book *An Outline of Money,* page 124, says, *"The modern tendency in economic thinking, indeed, is to discard the old notion of the quantity of money as a causative factor in the state of business and a determinant of the value of money and to regard it as a consequence".* Paul A. Samuelson, in his book *Economics – An Introductory Analysis,* page 293, takes a similar view to Crowther's in the following passage: *"The fact, however, that the quantity theory is a simplification of the truth and does not always hold with great precision should not be used to damn it utterly. If at least it indicates the general direction of economic behaviour, that would be a great deal to be said in its favour. Unfortunately, even this limited claim cannot always be made for the quantity theory".* It is apparent from these quotations that these two recognised economists ascribe only a limited importance to changes in the volume of money as causes of price movements. Similar views are expressed in the *Economic Journal* of March 1955 by Messrs E. H. Phelps Brown and S. A. Ozga after a study of long-term price trends in the United Kingdom.

11. Recent statistics show that between 1946 and 1954 the money supply in the United Kingdom rose by some 15 per cent. Over the same period the index of retail prices rose by over 50 per cent. This seems to indicate a probability that, in the main, the price increases in the United Kingdom arose from causes other than the moderate increase in the money supply.

12. Under Mr Kelliher's scheme, he claimed that the volume of money would remain constant unless some independent action was taken by the State to increase or reduce it. He considered that such increases or reductions should result only from deliberate actions by the State.

Velocity of Circulation

13. Mr Kelliher was at some pains to show that, in his view, velocity of circulation of money was of only minor importance in any assessment of the causes of inflation. He recognised that the greater use of existing money (i.e., an increase in velocity of circulation) might in certain circumstances (e.g., increasing import prices) avoid the need for increasing the money supply. In discussing velocity of circulation, however, Mr Kelliher omits to take into account the possibility that the operations of the Loanable Funds Scheme, by transferring dormant funds to savings deposits and making increased advances on the basis of

additional savings deposits so acquired, might stimulate considerably the velocity of circulation of the remaining demand deposits. Any such stimulation could have a similar immediate effect on spending, and on the price level, to an increase in the money supply. According to the Reserve Bank computation, the index of the velocity of circulation of money fell from 100 in 1939 to 50 in 1945, and has since risen to 70. If the velocity of circulation were to increase again to anything like the pre-war level of 100, there is no doubt that the effect would be considerable.

Legality of Credit Creation

14. Mr Kelliher disputed the legal right of New Zealand trading banks to operate as they do. Mr Otto admitted, under examination, that even under the Loanable Funds Scheme the banks would create and destroy money according to the accepted definition of money supply. It would appear, therefore, that the accusations of illegality made by Mr Kelliher would apply with similar force to the operations of trading banks if conducted under the Loanable Funds Scheme. The legal position regarding creation of money by trading banks is discussed in paragraphs 432 to 433, and 541 of our report and in Appendix D.

Moral Issues

15. Mr Kelliher raised the question *"whether the banks have any legal or moral right to create the original issue of money and to expand the money supply"*, and sought a recommendation from the Commission, in respect of creation of money by trading banks, *"that there is no legal or moral right to do what they have been doing, and it ought to be stopped"*. The Commission would scarcely wish to set itself up as a judge of morals. The trading banks could no doubt be held morally culpable if the lending operations complained of were either deliberately injurious to the public interest or if they had been conducted selfishly or regardless of the public interest. There is no evidence before the Commission to suggest that the trading banks have acted in such a way.

16. The allegation of moral wrong seems to be based on the assumption that all blame or a very large part of any blame for price increases should be ascribed to the lending operations of trading banks. In our view, for reasons explained elsewhere, this assumption is not well founded.

II. Full Reserve or 100 Per Cent Money

Influence of "100 Per Cent Money" on the Kelliher Proposals

17. Before outlining the mechanism of the Loanable Funds Account, Mr Kelliher gave a summary of the principles of "Full Reserve or 100 per cent Money", from which it became apparent that those principles had exerted a strong influence in the development of the Loanable Funds Scheme. Proposals similar to those of full reserve money were also submitted to the Commission by Mr A. N. Field. Full reserve or 100 per cent money was first advanced during the years 1930 to 1935 by Professor Irving Fisher and a group of economists at Chicago, U.S.A. In essence, this scheme involved bringing the balances of the trading

banks at the Central Bank, plus notes and coin held by the trading banks, up to the equivalent of 100 per cent of customers' demand deposits at the trading banks; thereafter, this 100 per cent ratio was to be maintained. The general effect of the scheme was to limit future trading-bank lending to the equivalent of repayments of overdrafts, sales of investments or other assets, plus increases in time deposits with the trading banks and any borrowing from the Central Bank.

18. Professor A. G. Hart, in *The Review of Economic Studies,* Volume II, page 104, described the original main objectives of 100 per cent money as:

(a) Removal of risk to customers' deposits.
(b) Repayment of United States public debt held by the trading banks.
(c) Control of inflation and deflation.

Professor Hart noted in 1935 that, in the United States, (a) and (b) were of historical interest only.

19. Apart from a temporary and partial experiment in Mexico, which apparently was abandoned because the 100 per cent requirement for additional deposits proved to be too rigid, it appears that the 100 per cent money scheme has not been adopted anywhere. Mr Colin Clark mentioned 100 per cent money in his evidence before the Commission, but he did not recommend it for New Zealand or for any sterling area country. Mr Clark considered that control over trading-bank advances, as far as the system could give it, could be exercised under the existing ratio system, and he also agreed that any increase of advances which did occur under the 100 per cent money scheme would have the effect of increasing the money supply in the hands of the public.

20. Part III of Mr Kelliher's submissions contained the following quotation from Benjamin Higgins' *Comments on 100 Per Cent Money (1931): "the degree of effectiveness of the plan in preventing over-investment depends upon the extent to which time deposits can be identified with savings and demand deposits with money"*. This statement is fundamental to the argument for 100 per cent money. Its application to the banking system of New Zealand today is of doubtful validity, because the evidence shows that the large amounts of dormant money included in the free deposits of the banks are really savings. The mere segregation of them from the remaining free deposits as proposed under the Loanable Funds Scheme would not change their character. Under the Loanable Funds Scheme the trading banks would be in a position to compete not merely for current savings, but also for past savings, including those held in the Post Office Savings Bank and other savings institutions. Notwithstanding these facts, under the 100 per cent money scheme, and under the Loanable Funds Scheme, any demand deposits which were transferred to time deposits would automatically entitle the trading banks to make additional advances of an equivalent sum.

21. According to the demonstration of 100 per cent money given by Mr Kelliher, it would have been necessary for the Reserve Bank to lend to the trading banks £142·7 million as at 30 June 1954, in order to bring their balances at the Reserve Bank, plus coins and notes, up to 100 per cent of demand deposits. Mr Kelliher preferred to submit his own variation of 100 per cent money, the Loanable Funds Scheme.

III. The Loanable Funds Scheme

22. Under the Loanable Funds Scheme the permissible limit to increases in trading-bank advances (or investments) at any time is determined by the balance remaining in a "Loanable Funds Account" appearing on the assets side of the bank balance sheet. On the liabilities side of the balance sheet there appears an account called by Mr Kelliher "Bank Demand Deposits". These two accounts have been specially devised for purposes of the Loanable Funds Scheme and are in addition to and apart from the normal processes of bank book-keeping. The Loanable Funds procedure ensures that any increase in the "Loanable Funds Account", such as a reduction in total advances to customers, is reflected in a corresponding increase in the account called "Bank Demand Deposits" and likewise any decrease in the Loanable Funds Account, as would arise from an increase in total advances to customers, would similarly decrease "Bank Demand Deposits".

The "Loanable Funds Account"

23. As mentioned above, under the Loanable Funds Scheme, future trading-bank lending and investment transactions are to be limited by the balance available from time to time in the Loanable Funds Account. Such balance will be increased by:

(a) Existing and future loans repaid to the banks.
(b) Amounts which the banks borrow from their customers on fixed deposits or from other sources.
(c) The sale of overseas exchange to importers and travellers.
(d) The sale of securities or other investments held by the banks.
(e) The profit which the banks make from interest, discount, exchange, etc.
(f) Any additional amount which shareholders or others may subscribe for further share capital, in the same way as other companies obtain further share capital for their businesses.
(g) Any advances which the Reserve Bank may be prepared to make to a trading bank under section 13 of the Reserve Bank Act.

24. On the other hand, the balance in the Loanable Funds Account will be reduced by:

(a) Advances by overdraft or other loans.
(b) Discounting of export bills.
(c) The purchase of investments, securities, buildings, or other assets.
(d) Payments to visitors from overseas in return for overseas money.
(e) The payment of administration and other expenses and dividends to shareholders.

25. The Loanable Funds Scheme would commence on the basis of the level of trading-bank advances in existence at the inception of the scheme. Any repayments of existing advances would be available for relending to bank customers. The scheme would, therefore, not reduce trading-bank advances below the total outstanding at the commencement of the scheme.

26. The Loanable Funds Account would operate in this way. The totals of the transactions are to be recorded in the Loanable Funds Account by a series of entries additional to the normal process of bank book-keeping. As the asset account "Loanable Funds" is increased or

reduced, a *contra* account on the liabilities side of the bank balance sheet, called by Mr Kelliher "Bank Demand Deposits", is similarly increased or reduced. The entries are so arranged that the balance of one account will always be the *contra* of the other, and therefore the balances would always be equal in amount. For example, repayment to a trading bank of an advance of £1,000 would increase by that amount both Bank Demand Deposits Account and Loanable Funds Account and so make the repayment of £1,000 available for relending. Similarly, an increase in advances of £2,000 would reduce the balances of the two *contra* accounts and so reduce the unexercised lending margin of the bank. These *contra* entries and accounts are merely a method of computing and recording the unused lending potential for the time being of the trading banks under the Kelliher scheme. The Loanable Funds entries make no difference to the effects on the economy of bank lending or borrowing transactions.

27. It is intended by Mr Kelliher that a Loanable Funds Account and a Bank Demand Deposits Account should be kept in the books of each branch of each trading bank. The Associated Banks commented on this as follows: *"The balances would be at best useless, and at worst completely misleading, as information to the branch managers. Some areas are traditional sources, and other areas users of funds. No particular branch balance would have any meaning, except as part of the overall total, on which Head Office policy would be based"*. We agree that the balances of these accounts at a particular branch would not necessarily be of any value in determining the appropriate limit of total advances for that branch.

Demonstration of Credit Creation

28. As already noted, the demonstration that trading banks may create and destroy money, or expand and contract the volume of money or the money supply by their lending and investment transactions, was based on the Reserve Bank definition of money supply applied to some thirty-two hypothetical examples, of which transactions one to twelve increase the money supply, thirteen to twenty reduce it, and twenty-one to thirty-two neither increase nor decrease it.

Change of Definition of "Money Supply"

29. Mr Kelliher recognised in principle that it was necessary to adopt a consistent terminology with precise meanings when speaking of bank transactions and of the money supply. He claimed, indeed, that throughout his demonstrations the definitions adopted by the Reserve Bank were accepted and used. Mr Kelliher adhered to the Reserve Bank definition of money supply in Part I of his submissions where he demonstrated that certain trading-bank transactions under existing banking techniques led to increases and decreases in the money supply, or, in other words, to the creation and destruction of money. When he demonstrated the working of the Loanable Funds Scheme, however, he departed from the Reserve Bank definition of the money supply and, in effect, changed not only the meaning of the term "money supply", but also the content of the statistical table, the total of which constitutes the money supply at any time.

Apparent Constancy of Money Supply Under Loanable Funds Scheme

30. By so changing the definition or content of the money supply, Mr Kelliher achieved an apparent constancy in the money supply, demonstrated in Part III of his submission, where he purported to show that certain transactions which increase or decrease the money supply under the present banking technique did not do so under the Loanable Funds Scheme.

31. Using the Reserve Bank definition of money supply, a specimen transaction in Part I of Mr Kelliher's submissions, showed that increased advances of £10 million may result in increased demand deposits at the trading banks of the same amount. Since the transaction did not reduce or otherwise affect any other part of the money supply, such as coin, notes in circulation, or demand liabilities of the State at the Reserve Bank, Mr Kelliher concluded correctly that there could be a corresponding increase of £10 million in money supply as defined by the Reserve Bank.

32. In Part III of the submissions, however, where the same transaction was dealt with in accordance with the Loanable Funds procedure, there was the same increase of £10 million in demand deposits held by the public, and again no alteration in the other items included by the Reserve Bank in its computation of the money supply. In this case there was no apparent increase in total money supply because, in order to preserve a constant total, Mr Kelliher introduced into the money supply table the fictitious item which he called "Bank Demand Deposits" and which is not properly part of the money supply because it is not available for spending by bank customers.

Results of Change in Definition of Money Supply

33. The effects of the same specimen transaction on the money supply, with and without this change in definition or in the composition of the money supply, are shown below:

—	Reserve Bank Definition Illustrated in Part I			Loanable Funds Definition Illustrated in Part III		
	Money Supply Before Transaction	Change Resulting From Transaction	Money Supply After Transaction	Money Supply Before Transaction	Change Resulting From Transaction	Money Supply After Transaction
	£ million	£ million	£ million	£ million	£ million	£ million
(a) Coin, notes, and demand deposits at Reserve Bank	71·7	..	71·7	71·7	..	71·7
(b) "Public demand" or "free" deposits	208·9	+10	218·9	208·9	+10	218·9
(c) "Bank demand deposits" ..	..	..	..	32·0	−10	22·0
(*d*) Total "money supply"	280·6	+10	290·6	312·6	Nil	312·6

34. A careful study of the above table reveals the following:

(a) *Coin, notes, and demand deposits at the Reserve Bank of New Zealand.*—There is no change in this item, which remains at £71·7 million in both instances.

(b) *Public Demand or Free Deposits.*—There is an increase of £10 million from £208·9 million to £218·9 million in this item in both cases. Up to this point, therefore, the effect of the transaction is identical in both cases.

(c) *"Bank Demand Deposits".*—It will be noted that, in the Loanable Funds examples, the increase in free deposits of £10 million is offset by a reduction of an equivalent amount in Bank Demand Deposits from £32 million to £22 million. Thus the real increase in the money supply which has occurred in both cases is obscured in the Loanable Funds example by introducing into the Loanable Funds computation of the money supply the fictitious item Bank Demand Deposits.

35. The details of the transactions used by Mr Kelliher in his demonstration to the Commission are shown in the table facing this page. It will be seen that in all these examples it is only by the introduction of the same fictitious item Bank Demand Deposits that he has maintained an apparently constant total of the money supply.

Loanable Funds Accounts at Other Branches of Trading Banks

36. In a special note Mr Otto suggested that Loanable Funds Accounts could be kept for each trading-bank branch at some branch of another trading bank. This variation, to which Mr Otto saw practical objections, would not justify the inclusion of Bank Demand Deposits in the Reserve Bank definition of money supply because paragraph (c) of the Reserve Bank definition, as set out by Mr Otto himself, includes these words *"free deposits held by customers in their bank accounts"*. Even if each trading-bank branch kept a Loanable Funds Account at some branch of another trading bank, the money could not be spent by bank customers and would not be purchasing power available to bank customers. **Thus the attempts to justify the inclusion of Bank Demand Deposits in the Reserve Bank definition of the money supply fail completely, not merely in logic but also in fact because, as mentioned above, Bank Demand Deposits, however they are recorded in the banks' books, are not money belonging to bank customers and therefore cannot be spent by them.**

37. The importance of definition upon the results of matters in argument can be gauged from Will Durant's *The Story of Philosophy*, page 59, where he says, *"How many a debate would have been deflated into a paragraph if the disputants had dared to define their terms! This is the alpha and omega of logic, the heart and soul of it, that every important term in serious discourse shall be subjected to the strictest scrutiny and definition. It is difficult, and ruthlessly tests the mind; but once done it is half of any task."* Again, in his book *Straight and Crooked Thinking*, Robert H. Thouless says, on page 192, *"The most obvious piece of crooked thinking which results from an absence of clear meanings is that in which a word is used in different senses in different parts of the same argument"*. This is precisely what Mr Kelliher has done, where repeatedly throughout his submissions he gives to the term "money supply" one meaning where he demonstrates that trading banks create and destroy money under the existing system, and a different and, in our view, a fallacious meaning, when he purports to demonstrate that under the Loanable Funds Scheme the trading banks would not create and destroy money.

TABLE TO APPENDIX F (reference paragraph 35 of Appendix).

Summary of Loanable Funds Transactions 1 to 11 Submitted by Mr Kelliher to Demonstrate the Working of the Loanable Funds Scheme Showing the Entries by Which an Apparent Constancy of Money Supply is Achieved

(£ million)

Transaction No. Pt. I	Transaction No. Pt. III	Details and Amount of Transaction		Trading Bank Liabilities: Total Liabilities	Trading Bank Liabilities: Capital and Reserves	Trading Bank Liabilities: Savings Deposits	Trading Bank Liabilities: Public Demand Deposits	Bank Demand Deposits*: Movements	Bank Demand Deposits*: Balance	Loanable Funds: Movements	Loanable Funds: Balance	Trading Bank Assets: Net Overseas Assets	Trading Bank Assets: Advances and Discounts	Trading Bank Assets: Investments	Trading Bank Assets: Land and Buildings	Trading Bank Assets: Coin, Notes, and Reserve Bank Balances	Trading Bank Assets: Total Assets	Loanable Funds Contra Entries	Dr.	Cr.	Money Supply, Including Bank Demand Deposits and Departing from Accepted Definition of Money Supply: Effect of Transaction	Money Supply, Including Bank Demand Deposits and Departing from Accepted Definition of Money Supply: Total After Transaction	Money Supply, Using Accepted Definition of Money Supply, i.e., Excluding "Bank Demand Deposits": Effect of Transaction	Money Supply, Using Accepted Definition of Money Supply, i.e., Excluding "Bank Demand Deposits": Total After Transaction
				299·3	7·6	50·8	240·9					21·3	149·4	26·0	4·4	98·2	299·3							
13	1	Repayment of advances ..	5	..	..	..	− 5	+ 5*	5*	+ 5	5	..	− 5	..	..	..	..	Loanable Funds .. Dr. To Bank Demand Deposits ..	5	5	− 5 + 5*	.. 312·6	.. − 5	312·6 307·6
14 and 29	2	Increase in savings deposits ..	5	..	..	+ 5	− 5	+ 5*	10*	+ 5	10	..	..	..	..	..	..	Loanable Funds .. Dr. To Bank Demand Deposits ..	5	5	− 5 + 5*	.. 312·6	.. − 5	.. 302·6
15	3	Sale of exchange to importers ..	15	..	..	..	−15	+15*	25*	+15	25	−15	..	..	..	..	..	Loanable Funds .. Dr. To Bank Demand Deposits ..	15	15	−15 +15*	.. 312·6	.. −15	.. 287·6
16	4	Sale of investments by trading banks	2	..	..	..	− 2	+ 2*	27*	+ 2	27	..	..	− 2	..	..	..	Loanable Funds .. Dr. To Bank Demand Deposits ..	2	2	− 2 + 2*	.. 312·6	.. − 2	.. 285·6
..	5	Increase in trading bank capital ..	5	..	+ 5	..	− 5	+ 5*	32*	+ 5	32	..	..	..	..	..	..	Loanable Funds .. Dr. To Bank Demand Deposits ..	5	5	− 5 + 5*	.. 312·6	.. − 5	.. 280·6
1	6	Increase in trading bank advances	10	..	..	..	+10	−10*	22*	−10	22	..	+10	..	..	..	..	Bank Demand Deposits .. .. Dr. To Loanable Funds	10	10	+10 −10*	.. 312·6	.. +10	.. 290·6
2	7	Increase in trading bank investments	3	..	..	..	+ 3	− 3*	19*	− 3	19	..	..	+ 3	..	..	..	Bank Demand Deposits .. .. Dr. To Loanable Funds	3	3	+ 3 − 3*	.. 312·6	.. + 3	.. 293·6
3	8	Payment to finance exports ..	10	..	..	..	+10	−10*	9*	−10	9	+10	..	..	..	..	..	Bank Demand Deposits .. .. Dr. To Loanable Funds	10	10	+10 −10*	.. 312·6	.. +10	.. 303·6
5	9	Capital transfer to New Zealand ..	2	..	..	..	+ 2	− 2*	7*	− 2	7	+ 2	..	..	..	..	..	Bank Demand Deposits .. .. Dr. To Loanable Funds	2	2	+ 2 − 2*	.. 312·6	.. + 2	.. 305·6
6	10	Purchase of bank building ..	1	..	..	..	+ 1	− 1*	6*	− 1	6	..	..	..	+ 1	..	..	Bank Demand Deposits .. .. Dr. To Loanable Funds	1	1	+ 1 − 1*	.. 312·6	.. + 1	.. 306·6
8	11	Repayment of savings deposits (wool retention)	4	..	..	− 4	+ 4	− 4*	2*	− 4	2	..	..	..	..	..	..	Bank Demand Deposits .. .. Dr. To Loanable Funds	4	4	+ 4 − 4*	.. 312·6	.. + 4	.. 310·6
Final balances				305·3	12·6	51·8	238·9	..	2·0	..	2·0	18·3	154·4	27·0	5·4	98·2	305·3							

*It is the inclusion of these fictitious items "Bank Demand Deposits" and contra entries marked * which enables the appearance of a constant money supply to be maintained throughout this series of Loanable Funds transactions. If the Reserve Bank definition of money supply is adhered to, the money supply would increase and decrease throughout these transactions as shown in the two columns on the extreme right of the table.

Facing page 410.

38. This point of definition is no mere formality but is of the greatest practical importance, because what is being measured in the Reserve Bank computation of money supply is spending power immediately available to the public or to the Government. It is through changes in money supply available to the public or to the Government that any inflationary or deflationary effects of expansion or contraction of bank credit work. If the public has more money to spend in the form of increased demand deposits at the trading banks, any measure of the money supply which does not reflect the increase is worthless and indeed misleading.

39. From the answers given by Mr Otto to the following questions it is clear that under the Loanable Funds Scheme a constant money supply is not achieved if the Reserve Bank definition of money supply is adhered to:

Question:

Do transactions 1 to 5 reduce public demand deposits from £240·9 million (see page 33 of Part III) to £208·9 million (see page 46 of Part III) . . . Do these transactions reduce the public demand deposits by £32 million?

Answer:

Yes.

Question:

In terms of the Reserve Bank definition does the combined result of entries 1 to 5 represent a reduction in the money supply of £32 million?

Answer:

Within the Reserve Bank definition – yes.

Also Mr Otto admitted that, in terms of the Reserve Bank definition, Loanable Funds transactions 6 to 11 *"represent an increase in the money supply or the creation of money by £30 million".*

40. Transactions 1 to 5 and 6 to 11 referred to above are the complete set of transactions submitted by Mr Kelliher in Part III of his submissions to illustrate the working of his Loanable Funds Scheme.

41. The claim by Mr Kelliher that the Loanable Funds Scheme eliminates the alleged fundamental defect of creating and destroying money through trading-bank lending and investment transactions therefore fails completely.

Further Claims for Loanable Funds Scheme

42. In addition to claiming that the Loanable Funds Scheme would remove what he called the fundamental defect in the existing banking procedure, Mr Kelliher made a number of other claims for the Loanable Funds Scheme which are discussed in the next few paragraphs.

Overseas Transactions Under the Loanable Funds Scheme

43. Mr Kelliher said that overseas transactions would neither increase nor decrease the money supply. However, the overseas transactions demonstrated (i.e., Loanable Funds transactions 3 and 8) caused part of the increases and decreases mentioned in paragraph 39 above. Mr Otto admitted these increases and decreases in the money supply provided that a consistent definition of money supply is adhered to.

Bank Advances in Times of Recession

44. Mr Kelliher claimed that under the Loanable Funds Scheme any calling up of bank loans during a recession would not destroy the nation's money supply. However, under cross-examination, Mr Otto admitted that a reduction of advances under the Loanable Funds Scheme could reduce demand deposits held by the public, and he also admitted that such a reduction would be destruction of money in terms of the Reserve Bank definition. Under the Loanable Funds Scheme the amount of money available for spending by the public would be reduced if there was a restriction of trading-bank advances. Any claim that the calling up of bank loans would produce less serious effects in a recession under the Loanable Funds Scheme than under the present system therefore fails.

"Borrowing to Lend" (refer main report – paras. 531 to 540)

45. Mr Kelliher contended that, under the Loanable Funds Scheme, the trading banks would *"borrow to lend"*, whereas he declared that at the present time they did not do so. Mr Otto admitted that under the Loanable Funds Scheme an advance might create a demand deposit. He also agreed that a demand deposit was a debt by the bank to the customer and was, in that sense, borrowed from the customer. The process of lending and borrowing under the Loanable Funds Scheme may be described as follows:

(a) An advance may create demand deposits.
(b) The trading bank may borrow the money so created – repayable on demand.
(c) By a change in the term of borrowing, i.e., from demand to, say, three months, the bank may acquire authority to lend further money.
(d) Such further lending may create more demand deposits which –
(e) The trading bank may borrow, repayable on demand, and –
(f) To the extent that customers agree that the term of borrowing may be changed to, say, three months, the bank acquires further authority to lend, and so the process could go on.

Indeed, according to Mr Otto, the above process could continue as long as the banks wanted to lend and as long as they could borrow from somebody. Thus it appears that, under the Loanable Funds Scheme, the trading banks would receive on fixed deposit some of the deposits which had originally been created as demand deposits through the process of bank lending.

46. When setting out to prove that the trading banks do not at present *"borrow to lend"*, Mr Kelliher made use of an example in which trading-bank advances were increased by £10 million and at the same time there was an increase of the same amount in demand deposits held by the public. He correctly pointed out that, in such an example, the trading banks have not used *"any part of their customers' demand deposits which were left completely untouched, nor do they use any part of their time deposits, which were also left completely untouched"*. On the strength of this demonstration Mr Kelliher concluded that the trading banks did not borrow to lend but created new money through increasing their

interest earning assets, i.e., their advances. Under cross-examination in respect of the demonstration of a similar transaction under the Loanable Funds technique, Mr Otto gave the following answers:

Question:

Were any public demand deposits used in Loanable Funds Transaction No. 6?

Answer:

No.

Question:

Were any time or savings deposits used in Loanable Funds Transaction No. 6?

Answer:

No.

47. The above answers show that, under the Loanable Funds Scheme also, the trading banks would not use any of the money borrowed from their customers, in increasing advances by £10 million. **Mr Kelliher has therefore completely failed to establish that any new principle of *"borrowing to lend"* is introduced by the Loanable Funds Scheme, but the effects on the money supply of bank lending are complicated and obscured by the special items Mr Kelliher has introduced.** The "Loanable Funds Account" and its counterpart "Bank Demand Deposits" merely record the extent of the banks' authority to lend under the Kelliher scheme at any time.

48. The Loanable Funds Scheme does no more than place a variable upper limit on trading-bank lending and this could be achieved under the existing system. There is no device in the Loanable Funds Scheme to prevent a reduction in bank lending if the banks decide to reduce their lending, or if there is a scarcity of borrowers. Such a development, if on a serious scale, would require action by the Government, possibly through purchases of securities by the Reserve Bank or by Reserve Bank lending to the Government or to the trading banks. Mr Kelliher also contemplated the sale of securities by the Reserve Bank in certain circumstances if trading-bank advances rise too high. Therefore, under the Loanable Funds Scheme, there is no effective automatic limit to trading-bank advances; neither is there any reason why trading-bank advances or the volume of money should be at the level most appropriate in the circumstances prevailing from time to time. As under the present system, some authority would require to exercise judgment as to the timing and nature of the intervention by the Reserve Bank.

49. A vital feature of the Loanable Funds Scheme is the fact that the extent to which the trading banks would be able to expand their lending operations would depend in the main on their ability to attract additional savings or fixed deposits.

50. Difficulty in achieving this could so circumscribe their operations that they would be unable to fulfil the traditional functions of the trading banks. Under examination Mr Otto conceded that the Loanable Funds Account would lack the flexibility of the existing banking system.

51. Despite this admission of lack of flexibility, Mr Kelliher stated in the pamphlet *Why your £ Buys Less and Less: "I advocate a more elastic and vastly improved banking technique whereby trading banks would be enabled to lend from the existing stockpile of money to the limit of credit-worthy borrowing . . ."*. In our opinion, expansion of bank lending *"to the limit of credit-worthy borrowing"* in recent years would have meant

that trading-bank advances would have been substantially higher than they are under the existing system. We can see nothing in the Loanable Funds Scheme itself which would offset the inflationary effects on the economy of such an expansion of trading-bank lending. Mr Kelliher suggested that increased lending under the Loanable Funds Scheme might be offset by open market operations by the Reserve Bank. We are very doubtful whether this would be effective because large-scale sales would upset the limited market for Government stock in New Zealand. In our view, expansion of trading-bank lending to the limit of credit worthiness of customers desiring to borrow would be highly undesirable under buoyant business conditions such as have existed in recent years.

Effects on Balance of Payments

52. It was submitted that the Loanable Funds Scheme would *"establish a mechanism which in itself would at all times contain forces working towards equilibrium in balance of payments"*. There are, however, certain features of the scheme which might well have the opposite effect. Mr Otto admitted that there was no special control in the Loanable Funds Scheme to prevent a spiral of advances arising from repeated transfers of demand deposits to savings deposits. He suggested open market operations by the Central Bank in the event of *"a dishoarding movement from past savings"*. We are doubtful whether the sale of securities in the open market on a scale sufficient to be a corrective would be possible in New Zealand without seriously upsetting the market. Such a spiral could increase the demand for imports and therefore accentuate any tendency to a balance of payments deficit. It was also admitted that running down their holdings of overseas funds would increase the Loanable Funds of the trading banks and thereby increase their lending ability and consequently their profits if lending was expanded. This part of the scheme, therefore, might accentuate disequilibrium in balance of payments.

53. It is appreciated, of course, that under the Loanable Funds Scheme the trading banks would be required to work within current receipts of overseas funds. Nevertheless it does appear that the two features mentioned in the previous paragraph would tend to make it more difficult for them to do so. The trading banks would either have to pay special regard to their balances of overseas funds and operate virtually on a sterling exchange standard by restricting advances to the extent necessary to curb the demand for overseas exchange, or else lend as freely as loanable funds would permit and take other steps to ration the available overseas exchange.

Loanable Funds Scheme as a Means of Controlling Bank Advances

54. There are important defects in the Loanable Funds Scheme as a means of limiting bank advances. The danger of a substantial expansion of advances, which would be possible if there was a free flow from demand deposits to savings deposits, has already been referred to. Mr Otto admitted that the increase of £39·7 million in bank advances, which took place in the year ended 31 March 1955, could have occurred under the Loanable Funds Scheme if there had been a shift of £40 million from free to fixed deposits. It appears possible, but not likely, that a very substantial increase in bank advances might take place on the institution

of the Loanable Funds Scheme through a transfer from demand to savings deposits especially if, as is proposed by Mr Kelliher, the trading banks were free to increase interest rates on deposits.

55. The evidence given by both Mr Whyte and Mr Fussell showed that there was a substantial amount of dormant or inactive money included in the free deposits at the trading banks. Tests conducted by the trading banks revealed that there was an amount of from £60 million to £85 million which had lain dormant for a period of at least a year. This was interpreted by the banks' witnesses to mean that the holders of these deposits preferred to keep them in a form which made them immediately available if required, rather than invest them. This view is strengthened by the fact that these depositors have available to them the opportunity of placing their moneys on fixed deposit with the banks for various periods of time, or, for that matter, of investment in a variety of securities.

56. It is apparent from the evidence that, in the main, the holders of these deposits will not be induced to move them from free to fixed or savings deposits by current rates of interest. In his evidence, Mr Otto said that the banks might need to offer a rate of interest as high as 4 per cent in order to obtain a substantial movement from free to fixed deposits. Mr Fussell thought the rate would need to be about 7 per cent to effect a shift of the order of £60 million to £85 million.

57. As the Kelliher proposals included the freeing of interest rates from control, it would appear that Mr Kelliher recognises that the rates of interest charged by the trading banks for advances would have to be increased substantially. Under his proposals the profits of the trading banks would arise chiefly from the excess of their lending rates over those paid for savings deposits.

58. Under the existing system the trading banks are able to conduct their lending operations without the need to effect any substantial movements from free to fixed deposits, whilst still deriving the advantages for this purpose which the dormant deposits provide. If, under the Loanable Funds Scheme, the banks were unable to induce a transfer from free to savings deposits of a considerable order, they would be unable to meet the needs of an expanding economy by increasing advances, or to meet emergencies which may arise from time to time, such as financing exporters (when stocks of primary products were accumulating) or merchants (when heavy shipments of imports may arrive in the country following a shipping strike).

59. Mr Otto admitted that, in circumstances similar to those mentioned above, the trading banks might have to seek the assistance of the Reserve Bank. Mr Whyte's evidence revealed a strong antipathy on the part of the trading banks to seeking the support of the Reserve Bank, no doubt arising from a traditional confidence in their ability to manage their own affairs.

60. It is obvious that Mr Kelliher's scheme would provide no assurance that the money supply would automatically be maintained at a level which was adequate, but no more than adequate, to enable the best use to be made of the country's resources. Judgment by the monetary authorities as to whether more or less money was required would be no less necessary under his scheme than under the present system.

61. Under the Loanable Funds Scheme there would be no independent control by the Reserve Bank, apart from any open market operations, and the trading banks would therefore be free to increase the existing level of advances by the equivalent of any increases in savings deposits.

62. Through the possibility of customers drawing suddenly on unexercised overdraft authorities, the banks would always be exposed to the risk of advances rising beyond the limit fixed under the Loanable Funds Scheme. This risk might compel the banks to adopt an ultra-conservative lending policy, by restricting advances until they had built up adequate working balances of loanable funds.

63. An important aspect of banking practice to which the Loanable Funds Scheme appears to attach little significance is bankers' cash. It is apparent to us that a situation could easily arise in which a trading bank had a balance available for lending in its Loanable Funds Account but insufficient bankers' cash to enable lending to proceed. For instance, a trading bank may have secured transfers from free to savings deposits, of, say, £2 million, thereby increasing its ability to lend, according to the Loanable Funds Scheme, by that amount. These transfers would not of themselves effect any change in bankers' cash, but increased lending would cause a drain on bankers' cash which the bank might not be in a position to meet.

64. If a bank's customers transferred through the operation of the cheque system more funds to customers of other banks than they received from them, that bank would lose bankers' cash to the other banks and its ability to make further loans to its customers would deteriorate. This situation could arise at a time when, according to the criteria of the Loanable Funds Scheme, the bank had increased its lending potential.

Possible Run on Savings Deposits

65. The Loanable Funds Scheme gives no protection to the trading banks in the event of a possible run on savings deposits and such a run could easily take place if previously the banks had been pressing their customers to transfer demand deposits to savings deposits. Under the Loanable Funds Scheme it is contemplated that savings deposits would increase substantially. The risk of a substantial draw-off from savings deposits would, therefore, be correspondingly greater. Under the Loanable Funds Scheme, also, advances would require to be contracted on a pound for pound basis to offset the effect of a run on savings deposits. It is clear that the scheme provides no safeguard against fluctuations in bank advances.

Summary of Conclusions Regarding the Loanable Funds Scheme

66. The results of the Commission's deliberations on the Loanable Funds Scheme are now summarised. The 100 per cent money scheme from which the Loanable Funds proposals were developed is not recommended for New Zealand, either by Mr Kelliher or by Mr Colin Clark. Its basic assumption that time deposits can be identified with savings is of doubtful validity if applied to this country at the present time. The Loanable Funds Scheme, which is a variant of 100 per cent money, is based on a similar assumption.

TABLE 29

Trading Banks: Liabilities and Assets, March 1935 to March 1955

(£(N.Z.) thousands)

Last Balance Day in March	Liabilities (in New Zealand)				Assets					
	Demand	Time		Total Demand and Time Liabilities	Bankers' Cash([1])	Net Overseas Assets	Securities		Advances and Discounts	Unexercised Overdraft Authorities
		Wool Retention Accounts	Other				Government	Other		
1935	27,674	..	35,455	63,129	9,470	22,794	N.A.	N.A.	44,573	N.A.
1936	31,946	..	36,530	68,476	13,285	19,258	5,082	307	44,919	N.A.
1937	36,898	..	31,975	68,873	12,808	15,286	7,617	296	46,954	25,230
1938	37,006	..	31,225	68,231	10,528	9,635	7,630	278	55,837	24,799
1939	38,447	..	29,878	68,325	13,982	4,646	10,063	266	55,517	23,539
1940	46,640	..	31,246	77,885	18,049	9,988	16,540	254	48,161	28,802
1941	53,682	..	28,630	82,312	17,860	12,239	15,434	540	53,680	29,894
1942	61,525	..	28,420	89,945	20,938	12,533	23,733	914	49,629	32,691
1943	77,139	..	25,559	105,698	24,446	14,852	36,166	1,193	44,931	34,326
1944	85,091	..	29,723	114,814	35,683	11,584	36,142	2,376	46,896	34,815
1945	93,656	..	30,837	124,493	39,172	15,623	29,025	2,502	55,148	37,073
1946	110,918	..	32,594	143,512	59,480	12,605	26,773	2,346	57,953	42,404
1947	126,791	..	35,396	162,186	62,199	14,602	21,058	2,177	73,011	44,039
1948([2]) ..	142,348	..	39,098	181,446	56,316	15,864	18,593	1,972	93,788	47,968
1949	145,501	..	37,512	183,013	68,155	16,749	14,432	1,850	89,606	52,342
1950	164,591	..	39,043	203,635	79,696	20,100	11,731	1,712	96,071	58,800
1951	193,709	9,644	39,770	243,124	60,784	31,504	11,715	1,574	133,271	70,364
1952	189,901	30,207	47,730	267,838	38,465	22,101	11,714	1,405	187,259	64,192
1953	200,271	24,061	35,951	260,284	81,376	25,742	11,687	1,175	140,449	84,582
1954	231,835	18,341	34,408	284,583	80,369	26,110	12,175	14,160	149,544	103,507
1955	236,095	12,582	49,100	297,776	53,819	25,915	11,846	14,114	189,257	98,641

([1]) Bankers' cash includes notes and coin, and balances at Reserve Bank.
([2]) On and after 20 August 1948 overseas assets and liabilities converted to New Zealand currency at rate, £(stg.)100 = £(N.Z.)100; previously £(stg.)100 = £(N.Z.)124.
(N.B.—This table does not include all items shown in the monthly returns.)

Source: Reserve Bank of New Zealand

TABLE 30

Volume of Money in Circulation in New Zealand(1) in Form of Coin, Notes, and Bank Demand Deposits, 1935 to 1955(2)

(All Figures refer to last balance day in March)

(£ million)

—	1935	1936	1937	1938	1939	1940	1941	1942	1943	1944	1945	1946	1947	1948	1949	1950	1951	1952	1953	1954	1955
Coin (estimated) ..	0·8	1·0	1·2	1·2	1·4	1·6	1·7	1·9	2·2	2·5	2·6	2·9	3·0	3·2	3·2	3·3	3·5	3·7	3·8	4·0	4·2
Notes held by public ..	6·2	7·1	9·8	9·5	11·2	14·8	17·2	20·2	26·2	31·2	34·2	36·6	39·6	40·8	42·2	44·3	48·1	49·8	51·5	57·3	60·7
Demand deposits at—																					
(a) Reserve Bank(3) ..	12·0	8·9	8·0	7·5	4·8	6·9	7·2	13·7	15·9	19·0	17·5	30·0	18·0	23·7	22·7	34·8	45·6	34·2	17·6	37·9	44·6
(b) Trading banks(4) ..	27·7	31·9	36·9	37·0	38·4	46·6	53·7	61·5	77·1	85·1	93·7	110·9	126·8	142·3	145·5	164·6	193·7	188·9	200·3	231·8	236·1
Total	46·8	49·0	56·0	55·3	55·8	70·0	79·8	97·2	121·5	137·7	148·0	180·4	187·4	210·0	213·5	247·0	291·0	277·6	273·2	331·0	345·7
Change during year ..	..	+ 2·2	+ 7·1	− 0·8	+ 0·6	+14·1	+ 9·9	+17·5	+24·1	+16·4	+10·2	+32·4	+ 7·0	+22·6	+ 3·5	+33·5	+44·0	−13·4	− 4·4	+57·8	+14·6

Causes of Changes in Volume of Money, 1935–36 to 1954–55

—	35–36	36–37	37–38	38–39	39–40	40–41	41–42	42–43	43–44	44–45	45–46	46–47	47–48	48–49	49–50	50–51	51–52	52–53	53–54	54–55
Overseas transactions(5) ..	− 1·4	−10·1	− 7·5	−16·8	+12·9	+ 8·0	+ 1·1	+ 6·0	+ 3·4	+24·6	+37·0	+ 0·2	−14·6	+5·8 (8)	− 1·5	+25·6	−21·0	+23·2	+27·1	−34·8
Bank credit—																				
Reserve Bank—																				
Advances and discounts ..	..	+ 7·1	− 1·8	+14·2	+ 2·7	− 3·7	+12·2	+ 1·8	+11·8	−14·6	+ 4·7	− 3·2	+12·2	+3·9	+19·6	+ 0·8	− 5·2	+ 1·8	− 0·7	+17·7
Investments in New Zealand	..	+ 1·0	+ 0·2	+ 0·2	+ 0·3	− 0·6	+ 0·4	+ 6·5	+ 0·4	− 0·2	− 8·9	− 0·6	+ 4·0	+3·0 (8)	+11·0	−12·0	−24·0	+ 8·0	+ 0·1	+ 0·2
Trading banks—																				
Advances and discounts ..	+ 0·3	+ 2·0	+ 8·9	− 0·3	− 7·4	+ 5·5	− 4·1	− 4·7	+ 2·0	+ 8·3	+ 2·8	+15·1	+20·8	−4·1	+ 6·5	+37·2	+54·0	−46·8	+ 9·1	+39·7
Investments in New Zealand	− 0·7	+ 2·5	..	+ 2·4	+ 6·5	− 0·8	+ 8·7	+12·7	+ 1·2	− 7·0	− 2·4	− 5·9	− 2·7	−4·3	− 2·8	− 0·2	− 0·2	− 0·3	+13·5	− 0·4
Shift from time to demand deposits at trading banks(6) ..	− 1·1	+ 4·6	+ 0·8	+ 1·3	− 1·4	+ 2·6	+ 0·2	− 0·1	− 1·2	− 1·1	− 1·8	− 2·8	− 3·7	+1·6	− 1·5	− 0·7	− 8·0	+11·8	+ 1·5	−12·9
Shift in Wool Retention Accounts (7)	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	−16·4	−13·8	+ 6·1	+ 5·7	+ 5·8
Other items	+ 5·0	− 0·1	− 1·3	− 0·4	+ 0·5	− 1·1	− 1·0	+ 1·9	− 1·2	+ 0·2	+ 1·0	+ 4·2	+ 6·6	−2·4	+ 2·2	+ 9·7	+ 4·8	− 8·2	+ 1·5	− 0·7
	+ 2·2	+ 7·1	− 0·8	+ 0·6	+14·1	+ 9·9	+17·5	+24·1	+16·4	+10·2	+32·4	+ 7·0	+22·6	+3·5	+33·5	+44·0	−13·4	− 4·4	+57·8	+14·6

(1) For explanation of treatment of wool retention balances see page 19 of *Reserve Bank Bulletin*, February 1951.
(2) Excludes deposits held at savings banks.
(3) I.e., Government and other demand deposits at Reserve Bank, excluding trading banks' balances and wool retention balances held at Reserve Bank.
(4) I.e., trading banks' total demand liabilities in New Zealand.
(5) As shown by changes in foreign exchange and overseas investments held by the New Zealand banking system in respect of New Zealand business, less overseas liabilities. Plus sign indicates that overseas exchange receipts exceeded disbursements, and minus sign indicates an excess of disbursements.
(6) Minus sign indicates shift from demand to time liabilities. Excludes movements of wool retention balances.
(7) Minus sign indicates movement into wool retention accounts, plus sign indicates withdrawals.
(8) Apart from the amount of £600,000 paid in cash by the Government to the Reserve Bank, the adjustments consequent on the exchange rate appreciation in August 1948 neither increased nor decreased the amount of money in circulation in New Zealand in the form of coin, notes, and bank demand deposits, and are therefore not included in the above table.

Source: Reserve Bank of New Zealand

TABLE 31

Index of Velocity of Circulation of Bank Deposits: Average of Monthly Figures for March Years, 1936 to 1955

—	Non-interest-bearing Deposits	Bank Debits	Index of Velocity of Circulation (Base: 1939=100)
Year ended March—	£ million	£ million	
1936	24·4	60·0	100·8
1937	28·7	73·2	104·3
1938	32·1	80·2	102·7
1939	32·3	78·6	100·0
1940	37·2	80·2	88·6
1941	46·1	86·2	76·9
1942	50·7	85·6	69·5
1943	63·5	90·1	58·3
1944	76·7	101·2	54·4
1945	85·4	108·6	49·8
1946	99·0	120·0	52·6
1947	114·4	146·6	60·9
1948	124·5	165·3	58·7
1949	133·0	190·1	57·7
1950	146·6	206·3	64·8
1951	165·3	259·5	69·7
1952	212·6	325·9	69·3
1953	206·6	302·4	65·8
1954	228·2	331·4	70·7
1955	237·0	380·8	69·7

Source: Reserve Bank of New Zealand

TABLE 32

Overseas Exchange Transactions, March Years, 1934 to 1955

(£(N.Z.) million)

—	1934	1935	1936	1937	1938	1939	1940	1941	1942	1943	1944	1945	1946	1947	1948	1949	1950	1951	1952	1953	1954	1955
Receipts																						
Exports	46·0	45·0	49·9	60·5	65·3	58·0	71·0	73·3	72·8	80·9	74·1	85·3	108·5	112·9	134·3	143·9	154·7	207·8	251·6	227·1	239·9	216·2
Other receipts	3·2	7·7	3·9	3·6	4·1	4·7	7·5	9·4	8·5	15·1	29·7	45·6	33·3	35·5	38·5	26·0	19·4	20·0	25·9	26·1	31·7	58·2
Total	49·2	52·7	53·8	64·1	69·4	62·7	78·5	82·7	81·3	96·0	103·8	130·9	141·8	148·4	172·8	169·9	174·1	227·8	277·5	253·2	271·5	274·4
Payments																						
Imports	26·1	32·6	37·6	47·8	58·3	54·6	37·9	44·2	41·9	35·1	30·8	33·6	38·0	72·6	124·7	109·0	135·1	169·6	252·6	201·1	200·4	252·9
Debt repayments (Government and local bodies)	2·8	2·9	3·8	5·8	0·7	0·9									14·6	4·7	2·5	0·8	0·1	0·1	0·2	0·4
Debt interest (Government and local bodies)	8·9	8·7	8·4	7·8	7·7	7·6	25·5	29·6	41·7 (2)	58·3	65·5	59·7	98·1(1)	57·7	5·0	3·6	3·1	2·7	2·7	2·7	2·9	3·1
Other payments	6·2	6·5	5·5	6·5	6·4	6·4									42·7	54·5	34·4	31·4	38·5	38·2	39·3	52·9
Total	44·0	50·7	55·3	67·9	73·1	69·5	63·4	73·8	83·6	93·4	96·3	93·3	136·1	130·3	187·0	171·8	175·1	204·5	293·9	242·1	242·8	309·3
Balance	+5·1	+1·9	−1·5	−3·9	−3·7	−6·8	+15·1	+9·0	−2·3	+2·6	+7·6	+37·6	+5·7	+18·1	−14·2	−1·9	−1·0	+23·3	−16·4	+11·1	+28·8	−34·9
Net overseas assets as at last balance day in March	..	45·8	44·4	34·4	26·9	10·1	23·1	32·3	32·8	40·1	44·2	67·1	104·1	104·3	89·6	75·0	74·2	99·8	78·8	101·9	129·0	94·2

(1) Includes payment of £22·7 million under memorandum of security.
(2) Includes payment of £3·7 million under memorandum of security.

NOTE.—The figures 1934 to 1939 are estimates published by the Government Statistician.

Source: Reserve Bank of New Zealand

TABLE 33

Movements in Reserve Bank's Discount Rate, 1934 to 1955

	Per Cent		Per Cent
August 1934	4	July 1941	1½
July 1935	3½	April 1954	3½
March 1936	2½	November 1954	4
June 1936	2	July 1955	5
November 1938	4	September 1955	6
September 1939	3	October 1955	7
May 1940	2		

TABLE 34

Minimum Ratios of Balances to Demand and Time Liabilities Required to be Maintained by Trading Banks at the Reserve Bank, 1934 to 1955

Prior to 1952	7%	of demand and	3%	of time liabilities
August 1952	10%	,,	5%	,,
December 1952 (informal agreement)	15%	,,	7½%	,,
May 1953	20%	,,	10%	,,
May 1954	25%	,,	12½%	,,
September 1954	20%	,,	10%	,,
December 1954	25%	,,	12½%	,,
February 1955	15%	,,	7½%	,,
June 1955	16½%	,,	7½%	,,
July 1955	20%	,,	7½%	,,
August 1955	21½%	,,	7½%	,,
October 1955	24%	,,	7½%	,,

TABLE 35

Balances Held at the Reserve Bank by Trading Banks in New Zealand, 1949 to 1955
(£000)

Date Last Balance Day in Month	Actual Balances at Reserve Bank	Statutory Minimum Balances	Borrowing(1)
1949—January	74,118	11,278	..
February	77,212	11,483	..
March	60,363	11,731	..
April	65,077	11,310	..
May	72,981	11,779	..
June	86,257	11,944	..
July	82,019	11,913	..
August	79,898	11,927	..
September	80,491	11,455	..
October	79,549	11,517	..
November	76,534	11,599	..
December	81,243	11,467	..
1950—January	88,965	12,507	..
February	88,869	12,589	..
March	69,277	13,374	..
April	76,991	12,693	..
May	83,973	13,579	..
June	76,879	13,365	..
July	75,101	12,786	..
August	72,249	12,625	..
September	70,822	12,231	..
October	72,302	12,277	..
November	70,210	12,566	..
December	62,579	12,712	..
1951—January	67,367	14,249	3,230
February	67,390	14,846	2,905
March	49,060	14,834	1,270
April	65,834	15,042	1,269
May	75,902	15,810	813
June	73,694	16,456	476
July	75,294	16,555	216
August	81,660	16,208	..
September	84,617	15,099	..
October	79,248	15,712	..
November	69,737	15,319	..
December	65,896	15,216	..
1952—January	62,841	15,485	..
February	54,396	15,795	..
March	24,643	15,909	..
April	33,210	15,631	..
May	41,098	15,505	..
June	44,426	15,586	..
July	44,370	15,470	..
August	50,299	21,461	..
September	56,029	21,063	..
October	63,187	21,317	..
November	68,452	21,358	..
December	71,992	21,584	..
1953—January	88,846	21,820	..
February	95,161	22,650	..
March	69,167	23,851	..
April	89,382	23,028	..
May	95,883	47,941	..
June	102,249	50,060	..
July	99,826	49,656	..
August	99,869	64,939	..

TABLE 35—*continued*

Balances Held at the Reserve Bank by Trading Banks in New Zealand, 1949 to 1955—*continued*

(£000)

Date Last Balance Day in Month	Actual Balances at Reserve Bank	Statutory Minimum Balances	Borrowing(1)
1953—September	97,976	47,690	..
October	95,428	47,443	..
November	96,849	47,244	..
December	88,979	48,623	..
1954—January	97,601	49,690	..
February	105,659	51,312	..
March	68,326	53,937	..
April	81,441	51,642	..
May	89,175	53,508	..
June	86,480	67,839	350
July	77,171	66,583	7,350
August	78,337	63,332	10,000
September	67,850	51,488	8,000
October	66,124	50,530	6,500
November	65,559	50,682	7,500
December	71,660	64,186	8,500
1955—January	80,496	67,575	6,000
February	79,187	67,437	3,000
March	44,346	41,541	14,000
April	49,801	40,040	14,000
May	44,398	41,589	5,250
June	45,449	44,158	1,915
July	51,858	51,182	8,130
August	54,361	53,562	12,315
September	56,952	53,012	6,675
October	60,156	57,900	9,250
November	59,019	58,300	10,455
December	58,965	58,303	7,835

(1) Excluding inter-bank borrowing, but including Treasury deposits and borrowing from the Reserve Bank.

Source: Reserve Bank of New Zealand

TABLE 36

Trading-bank Ratios: Average of Monthly Figures, 1934 to 1955

(Expressed as percentages)

Calendar Year	Demand Deposits to Total Deposits	Cash([1]) to Total Deposits	Cash([1]) Plus Net Overseas Assets to Total Deposits	Securities to Total Deposits	Advances and Discounts to Total Deposits	Cash([1]) to Demand Deposits	Cash([1]) Plus Net Overseas Assets to Demand Deposits
1934([2])	39·0	29·8	56·6	N.A.	67·9	76·3	145·0
1935	41·9	15·5	48·7	8·2	73·7	37·0	116·3
1936	46·1	19·0	46·0	8·4	70·0	41·3	100·0
1937	51·8	20·8	39·0	11·7	73·0	40·3	75·3
1938	53·1	17·5	28·2	12·0	85·1	32·9	53·0
1939	55·8	23·1	28·9	16·9	79·5	41·4	51·9
1940	60·8	25·7	40·1	21·4	60·6	42·2	65·9
1941	64·4	21·7	36·0	25·8	60·9	33·7	55·9
1942	69·0	25·8	40·3	30·5	49·0	37·4	58·4
1943	73·0	30·6	41·0	35·0	40·0	41·9	56·2
1944	74·4	33·1	43·1	32·4	39·3	44·4	57·9
1945	75·9	39·9	50·0	24·2	39·3	52·5	66·2
1946	77·3	44·8	53·0	18·8	38·5	57·9	68·6
1947	77·2	39·8	47·8	13·9	45·9	51·5	61·9
1948	77·4	38·5	46·1	10·6	48·4	49·8	59·5
1949	79·4	45·4	53·1	7·7	43·2	57·1	66·8
1950	80·8	41·8	50·2	6·5	45·4	51·7	62·1
1951	76·8	32·5	43·2	5·2	52·0	42·3	56·2
1952	73·4	24·9	31·6	5·1	65·2 ~~50·1~~	34·0	43·1
1953	78·3	39·2	46·8	5·2	50·1	50·1	59·7
1954	80·9	31·8	38·7	8·7	53·6	39·3	47·8
1955	82·0	23·7	30·2	8·7	62·3	28·9	36·8

([1]) Banks' cash includes notes and coin and balances at the Reserve Bank of New Zealand.
([2]) Last five months.

Source: Reserve Bank of New Zealand

TABLE 37

Classification of Trading-banks' Advances as at End of March 1937 to 1955

(£ million)

—	1937	1938	1939	1940	1941	1942	1943	1944	1945	1946	1947	1948	1949	1950	1951	1952	1953	1954	1955
1. Farmers—																			
(a) Mainly dairy	4·7	5·0	5·0	4·9	5·1	5·4	5·1	5·6	5·8	6·4	7·3	7·3	7·2	6·8	7·9	8·9	8·0	11·3	13·6
(b) Mainly wool	5·4	6·1	6·4	5·8	5·5	5·3	5·7	5·8	6·3	6·5	6·9	6·1	5·8	4·9	5·4	6·4	6·5	7·0	8·2
(c) Mainly meat	1·9	2·2	2·3	1·9	1·8	1·9	1·7	1·7	1·8	1·4	1·6	1·4	1·2	1·1	1·1	0·9	1·0	1·0	1·1
(d) Mainly agricultural	0·3	0·4	0·5	0·3	0·4	0·3	0·4	0·3	0·4	0·4	0·6	0·7	0·7	0·7	0·8	1·0	1·0	1·0	1·2
(e) Mixed	4·1	4·5	4·3	4·2	4·1	4·3	4·2	4·0	4·5	4·6	5·2	4·6	4·4	3·8	4·0	4·3	4·2	4·4	5·2
	16·5	18·1	18·5	17·1	17·1	17·2	17·0	17·4	18·7	19·3	21·6	20·0	19·3	17·3	19·2	21·5	20·6	24·6	29·3
2. Industries allied to primary production—																			
(a) Dairy companies, factories, etc. ..	1·3	1·7	2·6	2·1	2·3	1·7	1·3	1·0	1·2	0·8	1·2	0·8	0·6	0·5	0·7	0·8	0·6	1·3	2·8
(b) Freezing works, meat companies, etc.	0·9	1·7	2·6	3·3	7·4	6·5	5·2	5·7	7·0	7·8	7·7	7·4	8·6	9·4	13·9	18·0	6·8	5·0	13·8
(c) Woollen mills	0·6	0·8	0·6	0·5	0·2	0·4	0·4	0·2	0·6	0·8	0·9	1·5	1·5	1·4	2·1	3·9	2·8	3·2	3·7
(d) Wool buyers	..	..	..	..	..	..	..	..	..	..	..	..	2·3	5·4	11·2	4·1	2·8	4·2	5·5
(e) Other	1·3	1·9	1·4	1·5	1·8	1·3	1·4	1·4	1·3	1·6	3·8	4·5	4·2	4·3	4·3	6·6	7·2	7·1	7·5
	4·1	6·2	7·3	7·3	11·7	9·7	8·4	8·3	10·1	10·9	13·5	14·2	17·2	21·1	32·2	33·5	20·3	20·8	33·2
3. Other manufacturing and productive industries	3·9	4·6	4·3	4·2	4·9	4·9	4·2	4·8	6·7	6·5	8·3	14·2	15·0	14·8	20·5	32·5	26·6	22·9	28·6
4. Merchants, wholesalers—																			
(a) Mainly importers	3·3	4·2	3·5	1·9	2·4	2·2	1·8	1·5	2·0	2·5	4·3	8·0	5·9	7·6	10·7	21·0	12·1	11·0	14·1
(b) Others	1·4	1·1	1·4	1·0	1·3	1·1	1·2	1·4	1·2	0·9	1·4	4·9	2·2	2·8	3·1	6·2	4·7	4·0	5·3
	4·7	5·2	4·9	3·0	3·6	3·3	3·0	2·9	3·1	3·4	5·7	12·9	8·1	10·4	13·8	27·2	16·8	14·8	19·3

TABLE 37—*continued*

Classification of Trading-banks' Advances as at End of March 1937 to 1955—*continued*

(£ million)

——	1937	1938	1939	1940	1941	1942	1943	1944	1945	1946	1947	1948	1949	1950	1951	1952	1953	1954	1955
5. Retailers	3·3	4·1	3·6	3·0	3·1	2·8	2·0	2·0	2·8	3·1	4·6	9·5	7·7	8·3	11·3	20·7	14·0	14·9	19·2
6. Transport—																			
(a) Shipping	..	0·1	0·1	0·1	0·1	0·1	..	..	..	0·1	0·1	0·1	0·2	0·4	0·6	0·3	0·4	0·4	0·4
(b) Other	0·5	0·6	0·6	0·6	0·5	0·5	0·4	0·4	0·6	0·8	1·2	1·6	1·7	1·8	2·4	3·3	3·3	3·5	3·7
	0·6	0·7	0·7	0·7	0·6	0·5	0·4	0·4	0·7	0·9	1·3	1·8	1·9	2·1	3·1	3·6	3·7	3·9	4·0
7. All others—																			
(a) Local bodies, municipal authorities, public utility concerns, etc.	0·5	0·7	0·8	0·7	0·4	0·4	0·5	0·3	0·5	0·7	0·7	0·7	0·9	1·0	1·6	1·5	2·2	2·0	2·3
(b) Stock and station agents ..	0·6	1·4	1·4	0·7	0·5	0·5	0·5	0·8	1·0	0·7	1·0	0·7	0·6	0·6	1·4	4·5	3·1	1·7	3·2
(c) Hotels (public and private), restaurants, etc.	0·9	1·2	1·2	1·1	1·3	1·2	0·8	1·0	1·2	1·4	2·2	2·4	2·3	2·1	2·6	2·9	2·9	3·2	3·1
(d) Entertainment concerns ..	0·4	0·4	0·3	0·4	0·3	0·3	0·3	0·3	0·3	0·2	0·4	0·5	0·4	0·3	0·3	0·3	0·3	0·3	0·4
(e) Financial companies, societies, etc.	1·6	2·2	2·3	1·4	0·8	0·7	0·5	0·7	1·1	0·8	1·1	1·5	1·8	1·9	2·5	2·9	1·9	5·9	7·2
(f) Religious and charitable ..	0·4	0·4	0·4	0·3	0·3	0·3	0·3	0·2	0·2	0·2	0·2	0·3	0·3	0·3	0·4	0·6	0·7	0·8	0·7
(g) Professional	1·4	1·5	1·6	1·3	1·3	1·1	1·0	1·2	1·4	1·4	1·7	2·0	2·0	2·0	2·8	3·1	2·9	3·2	3·3
(h) Private individuals	4·9	5·6	5·2	4·9	4·8	4·7	4·5	4·8	5·6	6·2	7·7	8·5	8·3	9·2	14·6	18·8	16·9	20·9	23·6
(i) Miscellaneous	2·3	2·9	2·3	1·9	2·7	1·8	1·5	1·7	1·7	2·0	2·7	3·5	3·0	3·3	4·6	6·4	5·6	6·3	6·9
	13·1	16·1	15·5	12·7	12·4	11·1	9·8	11·0	12·8	13·7	17·6	19·9	19·6	20·7	30·7	41·0	36·4	44·4	50·6
Total advances	46·2	55·1	54·7	48·0	53·4	49·5	44·8	46·9	54·9	57·8	72·6	92·5	88·7	94·6	130·7	179·9	138·4	146·4	184·2

(1) Discounts are excluded.

Source: Reserve Bank of New Zealand

TABLE 38

Classification of Trading-banks' Total Overdraft Limits, March 1954 and 1955

(£(N.Z.)million)

—	March 1954: Total Overdraft Limits	March 1955		
		Advances	Unexercised Overdraft Authorities	Total Overdraft Limits
1. Farmers—				
(a) Mainly dairy	16·2	13·6	4·6	18·2
(b) Mainly wool	12·0	8·2	5·0	13·2
(c) Mainly meat	1·5	1·1	0·6	1·7
(d) Mainly agricultural ..	1·4	1·2	0·4	1·6
(e) Mixed	6·9	5·2	2·5	7·7
	37·9	29·3	13·1	42·4
2. Industries allied to primary production—				
(a) Dairy Companies, factories, etc.	3·8	2·8	4·0	6·8
(b) Freezing works, meat companies, etc.	12·2	13·8	4·8	18·6
(c) Woollen mills	4·2	3·7	0·7	4·4
(d) Other	21·6	13·0	9·2	22·2
	41·8	33·2	18·8	52·0
3. Other manufacturing and productive industries	40·1	28·6	14·4	43·0
4. Merchants, Wholesalers—				
(a) Mainly importers ..	19·4	14·1	8·1	22·2
(b) Others	6·9	5·3	3·6	8·9
	26·3	19·3	11·7	31·0
5. Retailers	23·5	19·2	7·7	26·9
6. Transport—				
(a) Shipping	0·9	0·4	0·6	1·0
(b) Other	5·4	3·7	2·3	6·0
	6·3	4·0	2·9	6·9
7. All others—				
(a) Local bodies, municipal authorities, public utility concerns, etc.	8·8	2·3	6·9	9·2
(b) Stock and station agents ..	7·3	3·2	5·1	8·3
(c) Hotel (public and private), restaurants, etc.	4·5	3·1	1·5	4·6
(d) Entertainment concerns ..	0·7	0·4	0·4	0·8
(e) Financial companies, societies, etc.	9·0	7·2	2·6	9·8
(f) Religious and charitable ..	1·5	0·7	0·7	1·4
(g) Professional	4·6	3·3	1·5	4·8
(h) Private individuals ..	28·3	23·6	7·7	31·3
(i) Miscellaneous	9·9	6·9	3·6	10·5
	74·6	50·6	30·0	80·6
Total advances	250·7	184·2	98·6	282·8

Source: Reserve Bank of New Zealand

TABLE 39

Post Office Savings Bank Deposits, Withdrawals, and Amounts to Credit, 1934 to 1955

(£000)

Year Ended March	Deposits	Withdrawals	Amount to Credit at 31 March
1934	19,429	17,818	44,870
1935	24,180	20,947	49,424
1936	25,620	23,534	52,916
1937	30,677	27,042	58,066
1938	33,041	29,629	63,147
1939	30,434	34,598	60,710
1940	25,151	29,463	58,002
1941	28,607	25,319	62,957
1942	32,045	25,377	71,445
1943	38,097	26,889	84,470
1944	47,649	35,580	98,614
1945	54,585	42,159	113,492
1946	67,861	55,626	128,514
1947	72,381	62,747	141,242(1)
1948	72,553	68,660	148,442(1)
1949	70,691	67,723	154,849(1)
1950(2)	11,448 77,963	3,793 73,306	170,982
1951	86,395	85,190	176,103
1952	98,206	93,749	184,639
1953	99,126	96,700	191,274
1954	109,340	99,135	205,922
1955	117,881	112,842	215,671

(1) Excludes balances to credit of war gratuity savings bank accounts in the years quoted of: 1947, £13,616,000; 1948, £12,439,000; 1949, £11,448,000.

(2) War gratuity accounts balances totalling £11,448,000 deemed to be Post Office Savings Bank accounts as from 31 March 1949. Of this amount £7,655,000 was left to credit and £3,793,000 withdrawn. Transactions shown separately for year 1949–50.

Source: Department of Statistics

TABLE 40

Trustee Savings Bank Deposits, Withdrawals, and Amounts to Credit, 1934 to 1955

(£000)

Year Ended March	Deposits	Withdrawals	Amount to Credit at 31 March
1934	5,818	5,742	10,848
1935	6,199	6,073	11,286
1936	6,652	6,487	11,773
1937	7,609	7,240	12,480
1938	8,137	7,639	13,339
1939	8,578	8,430	13,866
1940	8,184	8,523	13,907
1941	8,219	7,764	14,759
1942	8,514	7,570	16,130
1943	9,127	7,341	18,320
1944	11,013	8,864	20,914
1945	11,228	9,865	22,774
1946	15,954	12,054	27,254
1947	17,306	14,698	30,540
1948	16,137	15,622	31,778
1949	15,994	15,748	32,771
1950	17,616	16,234	34,943
1951	20,720	19,610	36,893
1952	22,937	22,373	38,334
1953	22,645	23,012	38,854
1954	24,321	22,958	41,132
1955	26,924	26,188	42,826

Source: Department of Statistics

TABLE 41

National Savings Deposits, Withdrawals, and Amounts to Credit, 1934 to 1955

(£000)

Year Ended March	Deposits	Withdrawals	Amount to Credit at 31 March
1934	..	..	..
1935	..	..	..
1936	..	..	..
1937	..	..	..
1938	..	..	..
1939	..	..	..
1940	..	..	..
1941(1)	718	..	718
1942	2,476	9	3,194
1943	2,425	25	5,666
1944	7,258	64	13,010
1945	7,267	178	20,457
1946	7,607	1,707	26,917
1947	6,175	2,306	31,560
1948	7,285	3,680	36,070
1949	7,032	3,943	40,197
1950	10,577	4,282	47,671
1951	9,469	5,311	53,214
1952	10,974	6,511	59,218
1953	10,419	8,427	62,930
1954	10,329	9,630	65,469
1955	11,128	10,282	68,228

(1) Six months only.

Source: Department of Statistics

TABLE 42

National Savings Bonds Purchased and Redeemed, 1934 to 1955

(£000)

Year Ended March	Purchase Value of Bonds Sold	Redemption Value of Bonds Redeemed	Year Ended March	Purchase Value of Bonds Sold	Redemption Value of Bonds Redeemed
1934	..	..	1945	2,609	..
1935	..	..	1946	1,314	521
1936	..	..	1947	457	2,089
1937	..	..	1948	493	2,936
1938	..	..	1949	435	3,170
1939	..	..	1950	458	2,421
1940	..	..	1951	499	1,644
1941	612	..	1952	537	619
1942	2,786	..	1953	219	712
1943	1,356	..	1954	360	555
1944	3,122	..	1955	339	550

Source: Department of Statistics

TABLE 43

Comparison of New Zealand Trustee Savings Banks' Balance Sheets, 31 March 1955

(Previous year's figures in brackets)

LIABILITIES

—	Auckland Amount	Auckland Percentage	Dunedin Amount	Dunedin Percentage	Invercargill Amount	Invercargill Percentage	New Plymouth Amount	New Plymouth Percentage	Hokitika Amount	Hokitika Percentage	Total Amount	Total Percentage
	£		£		£		£		£		£	
Ordinary depositors	26,521,103	80·5	6,139,589	74·9	6,200,415	90·7	3,494,266	69·7	459,442	88·2	42,814,817	80·0
	(25,617,257)	(80·7)	(6,020,059)	(73·7)	(5,833,069)	(90·3)	(3,198,782)	(68·3)	(452,649)	(88·6)	(41,121,816)	(79·8)
National savings depositors	4,339,100	13·2	1,619,375	19·7	450,562	6·6	1,315,085	26·2	..	..	7,724,122	14·4
	(4,176,055)	(13·1)	(1,720,036)	(21·1)	(463,371)	(7·2)	(1,296,958)	(27·7)			(7,656,420)	(14·8)
Staff provident fund	207,272	0·6	31,097	0·4	..	..	11,325	0·2	..	..	249,694	0·5
	(185,417)	(0·6)	(28,072)	(0·3)			(9,704)	(0·2)			(223,193)	(0·4)
Provision for taxation	87,577	0·3	15,334	0·2	22,200	0·3	13,198	0·3	2,233	0·4	140,542	0·3
	(61,442)	(0·2)	(16,170)	(0·2)	(17,702)	(0·3)	(13,568)	(0·3)	(2,107)	(0·4)	(110,989)	(0·2)
Provision for donations, etc.	30,000	0·1	5,000	0·1	4,000	0·1	..	..	..	..	39,000	0·1
	(20,000)	(0·1)	(5,000)	(0·1)	(4,000)	(0·1)					(29,000)	(0·1)
Reserves	1,751,562	5·3	389,783	4·7	159,430	2·3	179,221	3·6	59,145	11·4	2,539,141	4·7
	(1,678,931)	(5·3)	(375,933)	(4·6)	(138,172)	(2·1)	(163,756)	(3·5)	(56,126)	(11·0)	(2,412,918)	(4·7)
	32,936,616	100	8,200,178(¹)	100	6,836,607(¹)	100	5,013,095	100	520,820	100	53,507,316	100
	(31,739,102)	(100)	(8,165,270)	(100)	(6,456,314)	(100)	(4,682,768)	(100)	(510,882)	(100)	(51,554,336)	(100)
Reference section 24 (5B), Trustee Savings Banks Act 1948												
Reserves, less premises and property ..	1,601,562	..	332,733	..	98,468	..	162,908	..	57,581	..	2,253,252	..
	(1,539,931)	..	(332,733)	..	(105,253)	..	(153,131)	..	(54,566)	..	(2,185,614)	..
5 per cent of depositors	1,326,055	..	306,979	..	310,021	..	174,713	..	22,972	..	2,140,740	..
	(1,280,863)	..	(301,003)	..	(291,653)	..	(159,939)	..	(22,632)	..	(2,056,090)	..
Excess or deficiency	275,507E	..	25,754E	..	211,553D	..	11,805D	..	34,609E	..	112,512E	..
	(259,068E)	..	(31,730E)	..	(186,400D)	..	(6,808D)	..	(31,934E)	..	(129,524E)	..

(¹) Not in accordance with balance sheet.

Source: Associated Savings Banks of New Zealand

TABLE 44

Comparison of New Zealand Trustee Savings Banks' Balance Sheets, 31 March 1955

(Previous year's figures in brackets)

ASSETS

	Auckland		Dunedin		Invercargill		New Plymouth		Hokitika		Total	
	Amount	Percentage	Amount	Percentage	Amount	Percentage	Amount	Percentage	Amount	Percentage	Amount	Percentage
	£		£		£		£		£		£	
Current assets—												
Cash in hand and at bankers ..	1,805,298 (1,817,403)	.. ..	208,484 (292,590)	.. ..	120,136 (181,911)	.. ..	222,560 (143,993)	.. ..	34,094 (48,613)	.. ..	2,390,572 (2,484,510)	.. ..
Interest due and accrued, etc. ..	185,438 (182,860)	.. ..	44,696 (46,504)	.. ..	39,060 (38,363)	.. ..	20,998 (21,960)	.. ..	2,048 (2,003)	.. ..	292,240 (291,690)	.. ..
Investments—												
Fixed deposits	.. ..	.. ..	200,000 (200,000)	.. ..	435,000 (405,000)	.. ..	150,000 (150,000)	.. ..	.. ..	.. ..	785,000 (755,000)	.. ..
National savings deposits	.. ..	.. ..	.. ..	.. ..	.. ..	.. ..	40,000 (34,044)	.. ..	.. ..	.. ..	40,000 (34,044)	.. ..
New Zealand Government inscribed stock, etc.	14,865,712 (15,994,439)	56·4 (63·1)	3,158,416 (3,087,116)	52·1 (52·7)	3,076,505 (2,926,505)	53·9 (55·0)	1,565,485 (1,500,891)	48·3 (49·7)	225,348 (201,770)	46·8 (44·1)	22,891,466 (23,710,721)	54·7 (59·3)
National savings bonds	31,234 (43,789)	0·1 (0·2)	5,000 (5,000)	0·1 (0·1)	.. ..	.. ..	.. ..	.. ..	7,758 (7,554)	1·6 (1·7)	43,992 (56,343)	0·1 (0·1)
Local body debentures	3,360,063 (2,967,478)	12·7 (11·7)	531,336 (558,598)	8·8 (9·5)	1,262,602 (1,157,929)	22·1 (21·7)	152,252 (157,493)	4·7 (5·2)	13,669 (14,374)	2·8 (3·1)	5,319,922 (4,855,872)	12·7 (12·1)
First mortgages	8,118,271 (6,336,863)	30·8 (25·0)	2,363,213 (2,202,023)	39·0 (37·7)	1,373,060 (1,239,928)	24·0 (23·3)	1,520,415 (1,361,474)	47·0 (45·1)	234,818 (233,449)	48·8 (51·1)	13,609,777 (11,373,737)	32·5 (28·5)
Investments (*re* section 24 (4)) ..	26,375,280 (25,342,569)	100 (100)	6,057,965 (5,852,737)	100 (100)	5,712,167 (5,324,362)	100 (100)	3,238,152 (3,019,858)	100 (100)	481,593 (457,147)	100 (100)	41,865,157 (39,996,673)	100 (100)
National savings securities—												
New Zealand Government inscribed stock	4,326,000 (4,166,000)	.. ..	1,589,324 (1,687,834)	.. ..	455,800 (453,000)	.. ..	1,309,950 (1,279,950)	.. ..	.. ..	.. ..	7,681,074 (7,586,784)	.. ..
Cash in hand, etc.	13,100 (10,055)	.. ..	30,051 (32,202)	.. ..	.. (10,371)	.. ..	5,135 (17,008)	.. ..	.. ..	.. ..	48,286 (69,636)	.. ..
Fixed assets—												
Premises and property	150,000 (139,000)	.. ..	57,050 (43,200)	.. ..	60,962 (32,919)	.. ..	16,313 (10,625)	.. ..	1,564 (1,560)	.. ..	285,889 (227,304)	.. ..
Furniture and fittings	81,500 (81,215)	.. ..	12,608 (10,203)	.. ..	13,482 (10,388)	.. ..	9,987 (5,330)	.. ..	1,521 (1,559)	.. ..	119,098 (108,695)	.. ..
	32,936,616 (31,739,102)	.. ..	8,200,178(1) (8,165,270)	.. ..	6,836,607(1) (6,456,314)	.. ..	5,013,095 (4,682,768)	.. ..	520,820 (510,882)	.. ..	53,507,316 (51,554,336)	.. ..
5 per cent ordinary depositors ..	1,326,055 (1,280,863)	.. ..	306,979 (301,003)	.. ..	310,021 (291,653)	.. ..	174,713 (159,939)	.. ..	22,972 (22,632)	.. ..	2,140,740 (2,056,090)	.. ..

NOTE.—In comparing cash holdings with 5 per cent depositors' balances, fixed deposits and national savings deposits are taken into account.

(1) Not in accordance with balance sheet.

Source: Associated Savings Banks of New Zealand

TABLE 45

Building Societies' Deposits Received During March Years, 1934 to 1955

Year ended March—	£(000)	Year ended March—	£(000)
1934	1,414	1945	1,303
1935	1,635	1946	1,330
1936	1,950	1947	1,234
1937	2,203	1948	1,376
1938	1,902	1949	1,439
1939	1,982	1950	1,326
1940	2,063	1951	1,644
1941	1,645	1952	1,930
1942	1,456	1953	1,694
1943	1,274	1954	2,070
1944	1,258	1955	2,736

Source: Department of Statistics

TABLE 46

Deposits with Building and Investment Societies and Trading Companies, 1934 to 1947

As at 31 March	Building and Investment Societies				Trading Companies				Grand Totals
	At Call	3 Months and Under 2 Years	2 Years or Over	Totals, Building and Investment Societies	At Call	3 Months and Under 2 Years	2 Years or Over	Totals, Trading Companies	
	£	£	£	£	£	£	£	£	£
1934	437,257	672,578	2,128,275	3,238,110	3,292,740	1,004,031	1,691,344	5,988,115	9,226,225
1935	621,419	612,842	1,984,495	3,218,756	2,756,187	1,106,836	1,983,391	5,846,414	9,065,170
1936	684,599	712,219	2,218,803	3,615,621	2,583,167	1,077,754	1,887,648	5,548,569	9,164,190
1937	778,907	728,413	2,481,180	3,988,500	2,297,438	1,100,109	1,840,630	5,238,177	9,226,677
1938	804,443	755,811	2,680,419	4,240,673	2,154,307	1,045,739	1,897,136	5,097,182	9,337,855
1939	761,388	842,317	2,956,936	4,560,641	2,151,353	1,005,715	1,927,142	5,084,210	9,644,851
1940	735,746	873,444	3,205,931	4,815,121	2,111,470	1,148,445	1,867,442	5,127,357	9,942,478
1941	748,676	928,109	3,333,786	5,010,571	2,163,558	1,439,932	1,909,233	5,512,723	10,523,294
1942	698,724	761,865	3,588,966	5,049,555	2,072,634	1,101,813	2,520,567	5,695,014	10,744,569
1943	697,615	609,747	3,669,975	4,977,337	2,159,064	1,060,844	2,337,672	5,557,580	10,534,917
1944	700,125	562,605	3,869,484	5,132,214	1,635,665	1,209,096	2,260,818	5,105,579	10,237,793
1945	697,106	552,109	3,938,782	5,187,997	1,706,039	910,238	2,180,514	4,796,791	9,984,788
1946	707,714	537,919	4,102,331	5,347,964	2,342,723	1,037,871	2,095,624	5,476,218	10,824,182
1947	740,201	566,546	4,234,453	5,541,200	2,070,046	784,324	2,136,703	4,991,073	10,532,273

Source: Department of Statistics

TABLE 47

Statistics of Building Societies, 1933–34, 1938–39, 1945–46, 1949–50, and 1954–55

—	1933–34	1938–39	1945–46	1949–50	1954–55
Permanent societies—					
Number of societies	53	57	57	56	55
Investing shares—					
Number of shares	147,893	256,585	320,633	437,204	650,457
Members holding	12,310	17,334	22,030	26,152	27,060
Aggregate value (£ million) ..	1·48	1·81	2·50	4·63	7·13
Capital shares—					
Number of shares	534,155	588,915	622,176	656,075	809,855
Members holding	5,122	5,480	5,685	5,363	5,702
Aggregate value (£ million) ..	1·30	1·45	1·59	1·65	2·00
Terminating societies—					
Number of societies	44	38	34	25	18
Members holding investing shares	31,332	29,892	47,627	99,150	143,698
Number of investing shares ..	105,654	102,595	215,652	462,349	897,639
Value of investing shares (£ million)	2·13	2·09	2·83	4·79	10·77

Source: Department of Statistics

TABLE 48

Life Assurance: New Zealand Business, 1928 to 1954

BALANCE SHEET: ASSETS

All 10ffices Transacting Business in the Dominion

—	1928 Amount	1928 Percentage	1931 Amount	1931 Percentage	1934 Amount	1934 Percentage	1937 Amount	1937 Percentage	1939 Amount	1939 Percentage
	£		£		£		£		£	
Mortgages of property	6,633,765	27·6	7,575,314	20·6	7,990,928	19·0	10,466,620	21·3	12,079,828	22·9
Loans on policies	3,948,114	16·4	5,343,648	14·6	5,896,059	14·0	5,680,045	11·6	5,613,058	10·6
New Zealand Government securities	5,904,932	24·5	6,338,974	17·3	8,657,147	20·5	8,664,502	17·7	10,265,383	19·4
Securities of other Governments	40,000	0·2	63,255	0·2	91,608	0·2	89,839	0·2	108,191	0·2
Local authorities securities	3,483,417	14·5	13,299,074	36·3	14,736,437	35·0	18,201,378	37·1	18,672,997	35·3
Landed and house property	1,401,067	5·8	1,441,376	3·9	1,519,632	3·6	2,087,582	4·2	2,372,858	4·5
Other investments	5,959	..	106,091	0·3	182,793	0·4	115,624	0·2	554,794	1·1
Outstanding premiums	332,051	1·4	393,747	1·1	346,258	0·8	389,711	0·8	417,085	0·8
Interest accured and outstanding	291,515	1·2	539,812	1·5	507,352	1·2	481,352	1·0	530,041	1·0
Cash	182,604	0·8	312,066	0·8	978,920	2·3	642,144	1·3	778,053	1·5
Other assets	1,821,405	7·6	1,241,341	3·4	1,254,880	3·0	2,255,571	4·6	1,430,610	2·7
Total	24,044,829	100·0	36,654,698	100·0	42,162,014	100·0	49,074,368	100·0	52,822,898	100·0

—	1946 Amount	1946 Percentage	1950 Amount	1950 Percentage	1952 Amount	1952 Percentage	1953 Amount	1953 Percentage	1954 Amount	1954 Percentage
	£		£		£		£		£	
Mortgages of property	12,139,196	15·2	23,436,153	21·7	40,685,753	32·1	47,311,935	33·9	56,854,203	36·6
Loans on policies	3,575,154	4·5	3,607,654	3·4	4,026,948	3·2	4,103,459	2·9	4,195,253	2·7
New Zealand Government securities	33,867,654	42·3	43,340,622	40·2	39,155,895	30·8	42,101,216	30·1	46,219,613	29·8
Securities of other Governments	2,872,218	3·6	2,308,011	2·1	1,860,016	1·5	1,797,369	1·3	1,658,959	1·1
Local authorities securities	21,352,130	26·7	26,903,777	24·9	29,661,291	23·4	30,929,187	22·1	30,927,602	19·9
Landed and house property	2,146,891	2·7	2,702,309	2·5	3,178,158	2·5	3,426,941	2·5	3,756,901	2·4
Other investments	842,456	1·0	2,317,026	2·2	3,478,434	2·7	5,469,705	3·9	7,520,132	4·9
Outstanding premiums	469,746	0·6	640,987	0·6	856,621	0·7	943,440	0·7	1,066,510	0·7
Interest accrued and outstanding	695,795	0·9	914,002	0·8	1,035,174	0·8	1,149,414	0·8	1,283,859	0·8
Cash	907,901	1·1	684,840	0·6	1,299,662	1·0	1,082,475	0·8	602,916	0·4
Other assets	1,090,910	1·4	1,088,314	1·0	1,707,000	1·3	1,402,097	1·0	1,061,825	0·7
Total	79,960,051	100·0	107,943,695	100·0	126,944,952	100·0	139,717,238	100·0	155,138,773	100·0

Source: Life Offices' Association

TABLE 49

Life Assurance: New Zealand Business, 1928 to 1954

BALANCE SHEET—ASSETS: SUMMARY IN GROUPS

All Offices Transacting Business in the Dominion

Group of Assets	1928		1931		1934		1937	
	Amount	Percentage	Amount	Percentage	Amount	Percentage	Amount	Percentage
	£ million		£ million		£ million		£ million	
1. Finance on members' policies (loans on policies, which include premium advances) ..	3·9	16·4	5·3	14·6	5·9	14·0	5·7	11·6
2. Public lending (Government and local body loans)	9·4	39·2	19·7	53·8	23·5	55·7	26·9	55·0
3. Private lending and investment (mortgages, land and house property, and other investments)	8·1	33·4	9·1	24·8	9·7	23·0	12·7	25·7
4. Miscellaneous	2·6	11·0	2·5	6·8	3·1	7·3	3·8	7·7
Total	24·0	100·0	36·6	100·0	42·2	100·0	49·1	100·0

Group of Assets	1939		1946		1950		1954	
	Amount	Percentage	Amount	Percentage	Amount	Percentage	Amount	Percentage
	£ million		£ million		£ million		£ million	
1. Finance on members' policies (loans on policies, which include premium advances) ..	5·6	10·6	3·6	4·5	3·6	3·3	4·2	2·7
2. Public lending (Government and local body loans)	29·0	54·9	58·1	72·6	72·6	67·3	78·8	50·8
3. Private lending and investment (mortgages, land and house property, and other investments)	15·0	28·4	15·1	18·9	28·4	26·3	68·1	44·0
4. Miscellaneous	3·2	6·1	3·2	4·0	3·3	3·1	4·0	2·5
Total	52·8	100·0	80·0	100·0	107·9	100·0	155·1	100·0

Source: Life Offices' Association

TABLE 50

Investments of Various Financial Institutions as at 31 March 1934 to 1955

(£ million)

—	1934	1937	1939	1946	1950	1951	1952	1953	1954	1955
Reserve Bank(1)—										
Advances and discounts	.. (2)	7·1	19·4	34·3	66·8	67·6	62·3	64·1	63·4	81·9
Investments in New Zealand	1·5 (2)	2·5	2·9	0·6	38·0	26·0	2·0	10·0	10·2	10·3
	1·5	9·6	22·3	34·9	104·8	93·6	64·3	74·1	73·6	92·2
Trading banks(1)—										
Advances and discounts	41(3)	47·0	55·5	58·0	96·1	133·3	187·3	140·4	149·5	189·3
Investments in New Zealand	26(3)	7·9	10·3	29·1	13·4	13·3	13·1	12·9	26·3	26·0
	67(3)	54·9	65·8	87·1	109·5	146·6	200·4	153·3	175·8	215·3
Post Office Savings Bank—										
New Zealand Government securities	41·5	54·0	57·0	145·2	168·9	173·9	183·8	188·7	203·4	214·9
Local authority debentures	0·4	0·6	0·6	0·4	0·3	0·3	0·2	0·2	0·2	0·2
	41·9	54·6	57·6	145·6	169·2	174·2	184·0	188·9	203·6	215·1
National savings—										
New Zealand Government securities	..	..	..	35·0	45·7	50·1	55·2	58·2	61·0	63·5
Trustee savings banks—										
Mortgages	5·9	6·6	7·0	6·8	8·1	8·3	9·3	10·1	11·4	13·6
New Zealand Government securities	2·7	3·6	3·8	20·7	29·9	31·8	33·2	32·1	31·4	30·6
Local authority debentures	1·9	2·4	2·5	2·6	2·5	2·7	3·4	3·4	4·9	5·3
	10·5	12·6	13·3	30·1	40·5	42·8	45·9	45·6	47·7	49·5
Building societies—										
Loans	..	..	..	12·1	16·3	18·2	19·9	21·5	23·8	26·6
Other investments	..	..	..	1·4	1·7	1·8	1·7	1·8	2·1	2·3
	..	..	..	13·5	18·0	20·0	21·6	23·3	25·9	28·9

Insurance: life, fire, accident, and marine—										
Mortgages	8·2	9·8	11·6	12·5	18·7	23·7	33·3	41·2	48·2	58·1
Loans on policies	6·0	5·8	5·5	3·8	3·6	3·6	3·6	4·0	4·1	4·2
Local authority securities	16·3	19·3	19·9	23·3	25·7	28·1	30·0	30·9	32·4	32·6
New Zealand Government securities	15·0	16·3	15·6	38·8	51·7	55·3	50·6	49·0	51·9	56·6
	45·5	51·2	52·6	78·4	99·7	110·7	117·5	125·1	136·6	151·5
Government Superannuation Funds(4)—										
Mortgages	3·2	2·7	2·6	1·9	0·8	0·6	0·5	0·5	0·4	0·4
Local authority securities	0·8	1·0	1·1	0·9	0·6	0·5	0·5	0·5	0·4	0·4
Government securities	0·7	0·8	1·5	2·2	5·7	7·9	8·9	11·1	13·6	15·8
	4·7	4·5	5·2	5·0	7·1	9·0	9·9	12·1	14·4	16·6
National Provident Fund(5)—										
Mortgages	1·3	1·2	1·1	0·8	0·7	0·6	0·5	0·6	0·6	1·0
Local authority securities	0·2	0·5	0·5	0·4	1·1	1·7	3·7	7·1	8·3	9·1
Government securities	1·9	2·5	3·7	6·9	8·9	9·1	8·1	5·7	5·5	5·4
	3·4	4·2	5·3	8·1	10·7	11·4	12·3	13·4	14·4	15·5
Earthquake and War Damage Fund—										
Government securities	..	..	..	4·7	6·7	7·6	8·6	9·7	10·8	12·1
State Advances Corporation loan operations—										
Mortgages—										
Rural	42·5	50·9	25·5	23·6	36·6	39·0	41·2	46·3	49·7	50·5
Urban			26·1	23·8	38·4	41·0	44·0	53·2	59·7	65·6
Industrial loans							1·4	1·7	1·8	1·5
Government and local authority securities	4·6	3·2	6·2	7·8	4·4	4·4	4·4	5·3	7·1	7·5
	47·1	54·1	57·8	55·2	79·4	84·4	91·0	106·5	118·3	125·1
Public Trust Office—										
Mortgages	13·2	12·0	11·8	9·8	9·1	9·5	11·3	11·9	12·3	13·4
Local authority debentures	7·9	6·4	6·8	5·8	4·8	4·4	4·1	3·8	3·5	3·2
Government securities	2·9	4·5	4·1	7·8	4·4	4·7	4·0	4·0	4·4	4·6
	24·0	22·9	22·7	23·4	18·3	18·6	19·4	19·7	20·2	21·2

(1) Figures for last balance day in March except where otherwise indicated.
(2) September 1934.
(3) Assessed.
(4) Combination of Public Service, Railways, and Teachers' Funds for 1934, 1937, 1939, and 1946.
(5) Figures for previous December.

Sources: Reserve Bank of New Zealand and Department of Statistics

TABLE 51

Overseas Private Direct Investment in New Zealand, 1950–51 to 1954–55

(£ million)

—	1950–51	1951–52	1952–53	1953–54	1954–55
1. Increases in investment ..	6·7	12·4	9·7	1·6	11·4
2. Investment income accruing to overseas firms	7·5	5·8	7·1	10·3	10·2

NOTE.—1. Yearly increases of investment capital in New Zealand branches and subsidiaries of overseas companies are made up of:

Remittances in cash to New Zealand.

Imports into New Zealand in the form of plant and machinery and commercial stocks not paid for by the New Zealand affiliate.

Dividends declared but not remitted to Head Office.

Profits retained in New Zealand.

2. Includes total profits *after* New Zealand direct taxation irrespective whether remitted overseas or not.

New Zealand Direct Investment Overseas, 1950–51 to 1954–55

(£ million)

—	1950–51	1951–52	1952–53	1953–54	1954–55
3. Increases in investment ..	1·5	0·9	1·0	1·9	1·7
4. Investment income accruing to New Zealand firms	1·9	2·0	1·6	1·9	2·1

Source: Department of Statistics

TABLE 52

Domicile of New Zealand's Public Debt, 1910 to 1955

As at 31 March	Amount		Percentage	
	Overseas(1)	New Zealand	Overseas	New Zealand
	£(N.Z.)million	£(N.Z.)million		
1910	62	13	83	17
1920	99	102	49	51
1930	151	117	56	44
1933	174	118	60	40
1940	168	164	51	49
1941	169	190	47	53
1942	163	231	41	59
1943	169	305	36	64
1944	170	367	32	68
1945	170	403	30	70
1946	122	473	21	79
1947	122	483	20	80
1948	107	494	18	82
1949	83	534	13	87
1950	81	565	13	87
1951	80	589	12	88
1952	80	576(2)	12	88
1953	80	590	12	88
1954	90	617	13	87
1955	100	631	14	86

(1) Figures for 1933 and later years exclude £24,100,200 (£(N.Z.)30,125,250 for years 1933–48) contingent liability in respect of which interest payments have been suspended by agreement with the United Kingdom Government since 1931.

(2) This reduction is owing mainly to the fact that State Advances stock to the amount of £34 million held by the Treasury was sold to the Post Office Savings Bank and an equivalent amount of Government stock held by the Savings Bank was redeemed. As bonds issued by the Corporation are not part of the public debt, the result of the transaction was a reduction of £34 million in the public debt.

Source: The Treasur

TABLE 53

Interest on New Zealand's Overseas Debt, 1911 to 1955

As at 31 March	Amount	Percentage of Export Value	As at 31 March	Amount	Percentage of Export Value
	£(N.Z.)million			£(N.Z.)million	
1911	2·2	10·0	1947	4·7	4·4
1920	4·2	8·2	1948	4·7	3·4
1930	7·0	14·6	1949	3·3	2·2
1940	5·7	9·5	1950	2·8	1·8
1941	5·4	7·6	1951	2·6	1·3
1942	5·4	7·8	1952	2·6	1·0
1943	5·4	7·1	1953	2·6	1·1
1944	6·6	8·8	1954	2·6	1·1
1945	6·7	8·5	1955	2·8	1·1
1946	7·0	7·9			

Source: The Treasury

TABLE 54

Various Interest Rates in New Zealand Since 1933

(1) LONG-TERM GOVERNMENT BORROWING RATES

	Per Cent		Per Cent
1933	4	1946	3
1937	3½	1947	3
1939	4	1948	3
1941	{3¼ 3	1949 1950	3 3
1942	3	1951	3
1943	3	1953	3¾(1)
1944	3	1954	3¾(2)
1945	3	1955	4(3)

(1) Issued at discount – yield £3 19s.
(2) Issued at discount – yield £3 19s. 6d.
(3) Issued at discount – yield £4 2s. 4d.

(2) MAXIMUM LOCAL BODY BORROWING RATES

These at the time of the outbreak of the war were about 4¼ per cent – about ¼ per cent above Government borrowing rates. During the war they were gradually reduced to 3½ and in 1947 to 3¼ per cent, still generally about ¼ per cent above Government rates.

August 1952, rate increased from 3¼ to 4 per cent.
October 1955, rate increased from 4 to 4¼ per cent.

(3) RATES OF MORTGAGE INTEREST: YEARS ENDING MARCH

	Per Cent		Per Cent
1934	5·56	1945	4·51
1935	5·06	1946	4·10
1936	4·73	1947	3·85
1937	4·60	1948	3·90
1938	4·65	1949	3·98
1939	4·58	1950	3·99
1940	4·69	1951	4·09
1941	4·69	1952	4·15
1942	4·73	1953	4·29
1943	4·72	1954	4·49
1944	4·63	1955	4·69

NOTE.—Rates allowed by Capital Issues Committee (set up in April 1952):

	Per Cent
Mortgages—	
April 1952 **to** August 1952	4¼
August 1952 to February 1955	4½
Since February 1955	4¾
From 6 October 1955—	
Mortgages £10,000 to £20,000	5
Debentures	5
Preference Shares	5 (in some cases with participating rights).

(4) TRADING BANKS

	Minimum Per Cent	Maximum Per Cent
(a) *Lending Rates*—		
30/11/34 to 1/8/41	4½	6½ (in some instances more was charged).
1/8/41 to date	4	5

	3 to 6 Months Per Cent	6 to 12 Months Per Cent	1 to 2 Years Per Cent	2 to 3 Years Per Cent
(b) *Fixed Deposit Rates*—				
5/7/34 to 2/11/34	1½	2	2½	2¾
2/11/34 to 18/9/40	1¼	1¾	2¼	2½
18/9/40 to 17/7/41	¾	1¼	2¼	2½
17/7/41 to date..	¾	1¼	1¾	2

(5) TRUSTEE SAVINGS BANKS DEPOSITS

	Up to £200 Per Cent	Up to £500 Per Cent	£501 to £750 Per Cent
1/4/33 to 1/6/42	3	..	..
1/6/42 to 1/7/45	2½	..	..
1/7/45 to 1/4/55	2½	2½	..
From 1/4/55	2½	2½	2

(6) POST OFFICE SAVINGS BANK DEPOSITS

	Up to £500 Per Cent	£501 to £2,000 Per Cent	£2,001 to £5,000 Per Cent
1/8/34 to 1/8/41	3	2½	..
1/8/41 to 1/6/42	3	2	..
1/6/42 to 1/9/52	2½	2	..
1/9/52 to date	2½	2	1½

(7) DEPOSITS WITH LOCAL BODIES

	At Call Per Cent	3 to 6 Months Per Cent	Over 6 Months Per Cent
1/8/34 to 17/7/41	2	2¾	3
17/7/41 to date	1	1¼	1½

(8) STOCK, STATION AGENTS, AND TRADING COMPANIES DEPOSITS

—	Call	3 to 6 Months	6 to 12 Months	1 to 2 Years	2 to 3 Years	Over 3 Years	Not Less Than 4 Years
	Per Cent	Per Cent	Per Cent	Per Cent	Per Cent	Per Cent	Per Cent
1/8/34 to 17/7/41 ..	2½	3½	3¾	4	4½	4¾	..
17/7/41 to 1/11/45 ..	1½	1¾	2	2½	3	3½	..
1/11/45 to 18/12/52 ..	1½	1¾	2	2½	2¾	3	..
18/12/52 to date ..	1½	1¾	2	2½	2¾	3	3½

(9) BUILDING AND INVESTMENT SOCIETIES DEPOSITS

—	Savings Department	Call	3 to 6 Months	6 to 12 Months	1 to 2 Years	2 to 3 Years	3 to 4 Years	4 to 5 Years	5 to 7 Years	7 Years and Over
	Per Cent	Per Cent	Per Cent	Per Cent	Per Cent	Per Cent	Per Cent	Per Cent	Per Cent	Per Cent
1/8/34 to 17/7/41 ..	3	2	2¾	3	3¼	3¾	4	..	..	..
17/7/41 to 1/6/42 ..	3	1	1¼	1½	2	2½	3	..	..	..
1/6/42 to 1/11/45 ..	2½	1	1¼	1½	2	2½	3	..	..	..
1/11/45 to 1/7/46 ..	2½	1	1¼	1½	2	2¼	2½	..	..	..
1/7/46 to 20/11/52 ..	2½	1	1¼	1½	2	2¼	2¾	..	..	..
20/11/52 to 29/4/54..	2½	1½	1¾	2	2¼	2½	3	3½	..	..
29/4/54 to date ..	2½	1½	1¾	2	2¼	2½	3	3½	3¾	4

TABLE 55

Private Capital Investment in New Zealand, 1932–33 to 1954–55

(£ million)

—	Year Ended March—										
	1932–33	1938–39	1942–43	1945–46	1948–49	1949–50	1950–51	1951–52	1952–53	1953–54	1954–55
Private building (residential, commercial, and industrial) and alterations and additions	1	7	2	13	22	28	37	44	42	51	68
Other private capital investment ..	3	10	5	14	26	29	37	51	60	54	62
Changes in stocks	−3	+5	..	+5	−19	14	49	37	13	−21	29
Private capital investment	1	22	7	32	29	71	123	132	114	84	158

Source: Department of Statistics

TABLE 56

Index of Average Dwelling Costs (Compared With Other Relevant Price Indices), 1946 to 1955

—	Index of Average Dwelling Costs:	Retail Prices Index Numbers (All Groups):	Index of Wholesale Prices of Building and Construction Materials:	Index of Nominal Weekly Wage Rates of Buildings and Construction Workers Occupied in the Building and Construction Industry:
	March Year Following	Calendar Year	Calendar Year Average	Calendar Year Average
1946 ..	1000	1000	1000	1000
1947 ..	1074	1031	955	1047
1948 ..	1142	1113	1031	1100
1949 ..	1202	1132	1044	1169
1950 ..	1344	1196	1131	1241
1951 ..	1484	1328	1283	1417
1952 ..	1595	1431	1471	1464
1953 ..	1665	1496	1461	1578
1954 ..	1734	1566	1445	1689
1955 ..	1814([1])	1604	1485	1740

([1]) Provisional

Sources: Department of Statistics and New Zealand Official Year-Book 1955, p. 885

INDEX

NOTES—(1) All references are to paragraph numbers or parts of sections of the report or appendices.

(2) Numbers with no letter prefix refer to paragraphs in the main report.

(3) Paragraph numbers or parts of appendices have the relevant letter – A, B, C, etc. – as a prefix.

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