An Amended Irish Monetary System

By N. J. Gibson, Department of Economics, Queen’s University.

(Read before the Society on May 17th, 1957.)

Introduction

To understand the Irish monetary system it is necessary to know something of its development and of the general economic position of the Irish economy. It is a truism, but a very important one, that the Irish economy is highly dependent on exports and imports for its well-being. In 1955, to take a particular year, its Gross National Product at factor cost was £476 million,1 and its external payments and receipts on current account amounted to £232·6 million and £197·1 million respectively, or 48·9 per cent and 41·4 per cent respectively of the Gross National Product. Looking a little more closely at the external position we find that 59·6 per cent of total imports in value terms came from the United Kingdom and 89 per cent of exports went to it.2 Other years might be taken but a similar pattern would emerge. In other words, the Irish economy is an open one and bound to be subject to external economic influence. In particular its economic life is closely interlinked with that of the United Kingdom and it must expect to feel the impact of general economic conditions in that country. It is with this background continually in mind that we must carry on our discussion.

Now it can be taken as given that the Republic wants to follow an expansionary economic policy to bring about growing levels of income and employment. In this sense it wishes to follow an “independent” economic policy. From what we have seen of the openness of the Irish economy we can be sure that any such policy must necessarily have repercussions on its external economic position.

It would, I think, be widely accepted today that an economy placed in the position of the Republic, and with its over-riding aim, needs a co-ordinated and integrated economic and monetary policy. It is my belief that the present monetary system makes co-ordination unnecessarily difficult to achieve. The lack of co-ordination appears

---

1 I would like to acknowledge very helpful discussion with Professors K S Isles and C F Carter and Dr W Black in the preparation of this paper. However, they must not be held responsible for its shortcomings, nor can it be assumed that they necessarily agree with the views expressed in it. I would also like to acknowledge my indebtedness to many Irish bankers, who would doubtless prefer to remain anonymous, but who have kindly given of their time to discuss banking questions with me. And finally to express my gratitude to the Trustees of the Houblon-Norman Fund who generously gave me a grant to cover expenses in connection with some research on “Banking in Ireland.” This paper anticipates part of that work.


3 I T J S B Vol XXXI No 1 March, 1956. (Wherever it is not stated all statistics are from official sources.)
to involve the commercial banks, the Central Bank and the Government, but largely derives from the fact that the Central Bank has insufficient power over the monetary system to give it a consciously unified policy. The system could, I think, be strengthened and made more flexible by giving greater power and responsibility to the Central Bank.

In examining the system the paper falls into three main parts. The first briefly describes the present institutional arrangements and something of their background; the second analyses the behaviour of the system in recent years; the third suggests possible amendments and discusses some of the difficulties that might be encountered in making them.

Outline of the Present System.

It will be instructive to look at the monetary system in its historical setting.

When the Irish Free State was established it inherited, amongst other things, a well developed commercial banking system. This consisted of nine banks, not counting the National Land Bank, with a widespread network of branches throughout the country. At this time all of them had branches in what became Northern Ireland, and the National Bank, not to be confused with the National Land Bank, had also some in England. This is still very largely the framework to-day except that the Belfast and Royal Banks arranged a swap of branches in 1923 and now confine their activities to Northern Ireland and the Republic respectively. These banks had grown up as part of the British monetary system; their conception of what was sound banking was essentially British. They were, at least nominally, steeped in the tradition of self-liquidating loans and lending short. They paid interest on deposit accounts, engaged in discounting, made use of the facilities of the London money and capital markets and determined their interest rates in relation to the discount rate of the Bank of England. Such practices, granted the particular economic environment, plus a large accumulation of sterling by the banks during the First World War, gave to the Irish Free State a financially strong banking system.

It was natural and indeed necessary that the new State should take an interest in the monetary system. In 1926 the Government appointed a Banking Commission whose reports provided the basis of the 1927 Currency Act. These reports need not be examined in detail, though it is necessary to make a negative point about them. On the whole the Banking Commission did not concern itself

---

4. The Bank of Ireland, Hibernian, Munster & Leinster, National, Northern, Provincial, Royal, Ulster and Belfast. The National Land Bank was taken over by the Bank of Ireland and its Dublin branch retained as the National City Bank.

5. The Royal has now a branch at Birkenhead and the National has branches in Wales.

6. Of total assets of some £247 million in 1921, £83 million was investments, about £10 million money at call and £21 million treasury bills. See Final Reports of the Banking Commission, 1926, pp 57-58.

7. No. 32 of 1927.
with what we would call monetary management, possibly because it believed that it could not be effective in Ireland. This seems to emerge from the brief discussion whether or not to establish a central bank.8

Of the recommendations of the Banking Commission one was that a Currency Commission should be established to control the currency. As is well known, the Currency Commission was subsequently established under the 1927 Currency Act. It was a body corporate and consisted of seven members, a Chairman and six ordinary Commissioners, three of whom were elected by what was called the shareholding banks. These were the banks, eight in number9 that held the capital of the Commission. The three other ordinary Commissioners were nominated by the Minister for Finance; the Chairman being elected by the six ordinary Commissioners. The Commission was a sort of semi-public body and closely associated with the banks.

The Currency Act, implementing a further recommendation of the Banking Commission, established the Irish Free State pound as the standard of value within the State. It was defined in terms of the pound sterling at the time and provision was made for it to take two forms, a legal tender note and a gold coin. The latter, however, never became effective. In fact the Irish Free State came to have a sterling exchange standard with a 100 per cent. gold and sterling backing for its legal tender note issue. The practical basis of management of this standard was that Irish legal tender notes were issued to any amount against money of the same nominal amount that was legal tender in Great Britain. The notes were made redeemable in British legal tender in London at the London agency, the Bank of England, and in Dublin on the option of the Commission.

The sterling obtained against the issue of legal tender notes was held in a capital fund called the Legal Tender Note Fund. The assets of this fund were to consist of gold or sterling in various forms. However, sterling securities with more than twelve months to maturity could not be held as cover for the note issue. This restrictive provision did not remain long on the statute book; it was repealed by the Currency (Amendment) Act, 1930.10

This Amendment Act requires a slight digression which is relevant to later parts of this paper. Section three of the Act contains a somewhat startling provision in view of the 100 per cent. external reserve principles laid down as the cover requirement for the legal tender note issue in the principal Act. It allows the Minister for Finance on request from the Commission "... to add any particular security or class of securities, currency, balance or other form of assets to the forms in which the legal tender note fund ... may be held under the Principal Act."11 The Minister can do this by a statutory order. The rules governing the making of such an order were slightly altered under the Central Bank Act, 1942.12 The position is that such orders must be laid before each House of the Oireachtas. If

---

8 Ibid., pp. 36-38. See also First Interim Report Banking Commission, 1926.
9 The same as those mentioned in footnote 4 above, excluding the Belfast and National Land Banks.
10 No. 30 of 1930
11 No. 30 of 1930, s 3 s s (1)
12 No. 22 of 1942 s. 64
the requested change has not the unanimous consent of the Com-
mis sion or, as it is now, the Board, the order must be approved by
res olution of each House. Where the request has been unanimous
it has the effect of law unless annulled by either House.

It was not until August of last year that any such order was made.
The forms in which the assets of the legal tender note fund may be
held now includes the currency and securities of the Federal Govern-
ment of the United States.\textsuperscript{13} This gives the legal tender note fund
a more cosmopolitan look whilst retaining the 100 per cent external
reserve principle. But as we have seen, even this could be altered
by an order of the Minister for Finance given the consent of the
Oireachtas.

To return to the Currency Act. It provided for the formation of
two other funds, the Note Reserve Fund and the General Fund. It
is not necessary for my purposes to comment on the former, except
to say that it was a capital reserve fund and was wound up under the
Central Bank Act, 1942.

The General Fund might be roughly described as a residual fund
to which accrued the income of the Commission earned mainly on the
assets of both the Legal Tender Note Fund and the Note Reserve Fund,
and from which was paid dividends, surplus income to the Govern-
ment and all other expenses of the Commission. It was stated that
the Commission might "exercise the functions of a banker in relation
to the moneys for the time being in the general fund."\textsuperscript{14} Whatever
the intention, this appears to have had no significance under the
Commission.

One further feature of the Act, a recommendation of the Banking
Commission, needs to be mentioned. This provided for what was
called a consolidated note issue by the shareholding banks in place
of the issue that six of the nine banks had made under the 1845 Bankers'
(Ireland) Act.\textsuperscript{15} The consolidated notes were notes issued by the
Commission to the banks, bearing the name of the respective bank
which was responsible for their payment on demand in legal tender.
Each bank had a fixed limit to its issue. Thus, I think, gives for
my purposes a sufficient outline of the provisions of the Currency
Act.

The Irish Free State gave statutory recognition in its currency
legislation to what was already a fact, the existence of a sterling
exchange standard. It sustained this by establishing a semi-public
Currency Commission, mainly to issue and redeem legal tender notes
defined to be identical with sterling and managed on the 100 per cent
external reserve principle; the reserves in question being almost
entirely sterling. The other part of the monetary system was the
commercial banks which were able to act independently of the Cur-
rency Commission except where the note issue was concerned. This
was the intention and was possible because of the banks large holdings
of sterling and their ease of access to the London money and capital
markets.

\textsuperscript{13} \textit{See S.I. No 230 of 1956, Currency (Amendment) Act, 1930 (Section 3),
Order, 1956.}

\textsuperscript{14} \textit{No 32 of 1927, s 63, s s (3)}

\textsuperscript{15} The Hibernian, Royal and Munster and Leinster Banks had no note issue
under the 1845 Act.
In 1934 a further Banking Commission was appointed with wide terms of reference. The massive researches of this Commission appeared in 1938. Their report includes a profound and on the whole undated analysis of the Irish economy. It is necessary to look very briefly at certain aspects of that analysis, though it will be impossible to do it justice in the space available.

Certain developments at the time caused the Commission some anxiety. They felt, for instance, that the continuous deficits in the balance of payments on current account needed careful watching. Loss of external assets and the prospects of future income from them could not be looked upon with equanimity, particularly if such loss did not contribute to export capacity. On the significance of Government economic policy they had a good deal to say. In particular they were very much alive to the possible repercussions of State borrowing from the banking system on the balance of payments and on the net external assets of the banks. They believed that the banks' relatively large holdings of net external reserves, and other holdings of sterling might "lead to the maintenance of an unbalanced position for a considerable period before any strain (was) experienced." They felt that there was "... little or no danger of any inflationary expansion of private credit by the commercial banks."

A further feature of Government financing worried the Banking Commission. The Government apparently neither consulted the banks nor the Currency Commission at the policy-forming stage with regard to its wider monetary implications. They recommended "that arrangements should be made for regular consultation with the monetary authority by the Government on all matters which may be expected to have monetary repercussions." Rightly or wrongly, they decided that this should not be a statutory obligation.

Though the Banking Commission believed that in general the Currency Commission had worked satisfactorily, and that the supply of credit through the banking system had been adequate, they decided that the powers of the Currency Commission should be extended, in particular that it should be given more specific "central banking" functions. At the same time they realised, in view of the net external assets of the banks, that the latter would not need to rely on a Central Bank except, perhaps, in an emergency. They appear to have visualised a possible sudden internal demand for notes. They recommended the continued maintenance of parity with sterling and the retention of the 100 per cent. gold and sterling backing for the note issue. So strongly did they feel about this that they suggested the repeal of Section 3 of the Currency (Amendment) Act, 1930.

As we have seen, this gives wide powers over the kind of assets that may be held

---

16 Commission of Inquiry into Banking, Currency and Credit, 1938, p. 94, par 153.
17 Ibid., pp 160, 170, par. 270.
18 Ibid., p. 222, par. 354.
19 Ibid.
20 Ibid., p. 218, par. 348 and p. 220, par. 352.
21 Ibid., p. 243, par. 376.
22 Ibid., p. 243, par. 364.
23 Ibid., p. 247, par. 380.
24 Ibid., p. 245, par 377.
in the Legal Tender Note Fund. The subsequent Central Bank Act implicitly accepted the maintenance of parity with sterling and the 100 per cent. reserve principle, but it did not repeal the wide powers allowed in Section 3 of the Currency (Amendment) Act. Notwithstanding this the Central Bank Act did implement many of the recommendations of the Commission and we may therefore postpone their consideration until we come to discuss that Act.

In so far as one can generalise about the findings of the Banking Commission I think it might be said that they gave the current arrangements a vote of confidence. Their misgivings were far more concerned with Government policy and the repercussions this might have on the monetary system. Indeed their fear of Government misuse of the banking system was one of the factors that determined the powers of the future Central Bank. Despite this fear, however, and the realisation that an unbalanced external position might persist for some time they did not attempt to provide a solution save that of consultation between the Government and the monetary authorities. Let us now turn to the Central Bank Act, 1942.

The Act provided for the dissolution of the Currency Commission and for the establishment of a Central Bank. All the property, powers and responsibilities of the former were vested in the latter, subject to any alterations made in the Act. The Central Bank is controlled by a Board of Directors consisting of a Governor, three banking directors who are representative of the commercial banks, and not more than five other Directors, two of whom may be Civil Servants. The capital of the Central Bank is held by the Minister for Finance, thus doing away with the principle of shareholding banks. The Central Bank has the general responsibility within its legal powers of safeguarding the integrity of the currency and ensuring that, in what pertains to the control of credit, the constant and predominant aim shall be the welfare of the people as a whole. The Minister for Finance may request the Central Bank to consult with him in the execution of this responsibility.

Unlike the Currency Act the Central Bank Act set out in some detail the purposes for which the General Fund might be used. For instance, the Central Bank may receive non-interest bearing deposits from a Minister of State, a Public Authority, an Associated Bank or any other bank or credit institution carrying on business wholly or partly within the State. It may rediscount exchequer bills, bills of local authorities and first-class commercial bills. To do this it is empowered to publish a minimum rate of discount. It may, with the resources of the General Fund, engage in open market operations in Trustee and Government Securities provided these have been previously offered for public subscription. It has also the power to hold the securities of, or those guaranteed by, the Government of any other country. The Act provided for the gradual abolition of the consolidated note issues of the banks giving the Central Bank a monopoly of note issue within the State.

\[^{25}\text{No. 22 of 1942 s 6 s (1).}\]
\[^{26}\text{An "Associated Bank" is one that is officially associated with the Central Bank in the smooth working of the currency system, is a licensed banker and maintains a register in the State of their local shareholders. See No 22 of 1942 s 12-s 14 and No 32 of 1927, s 42-s 43, for further details.}\]
Finally, reference must be made to Part VI of the Act and its potentially far-reaching provisions, though without considering these in detail. Under these the Central Bank may, with the consent of the Minister for Finance, make regulations requiring every licensed bank to place non-interest bearing deposits with it. The bank may have to deposit a definite amount or an amount "... calculated in a specific manner."\(^{27}\) Whenever its assets within the State fall below a specified proportion of its liabilities within the State it must maintain the deposit as long as its assets are below the specific proportion. Different banks may be given different requirements. The Central Bank may, again with the consent of the Minister for Finance, make regulations requiring licensed banks to settle interbank indebtedness by cheques drawn on itself. Similarly, it may require licensed banks to lodge with it for clearance, cheques, bills, notes or other negotiable instruments payable outside the State and which have been lodged at an office of the bank within the State. No regulations have been made with regard to compulsory deposits or clearing arrangements.

We have now seen something of the institutional framework of the Irish monetary system. That substantial powers lie dormant in the legislation governing the system no one can deny. It is our task in the next section to see how the system has functioned in recent years.

**Behaviour of the System in Recent Years.**

Our first task will be to look at the behaviour of the banks as disclosed by their changing asset and liability pattern. Table I shows certain selected assets and liabilities within the State of the Associated

### TABLE I

**Selected Assets and Liabilities within the State**

<table>
<thead>
<tr>
<th>Quarter ended December (1)</th>
<th>Deposits (2)</th>
<th>Loans and Advances (3)</th>
<th>Government Bills and Investments (4)</th>
<th>Total Liabilities (5)</th>
<th>Total Assets (6)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1938</td>
<td>114 0</td>
<td>46 6</td>
<td>6-5</td>
<td>132-5</td>
<td>71-1</td>
</tr>
<tr>
<td>1946</td>
<td>224 6</td>
<td>51 9</td>
<td>8-0</td>
<td>245-6</td>
<td>85-4</td>
</tr>
<tr>
<td>1947</td>
<td>237 6</td>
<td>82 0</td>
<td>8 8</td>
<td>261-2</td>
<td>121-5</td>
</tr>
<tr>
<td>1948</td>
<td>238 3</td>
<td>88-6</td>
<td>9 9</td>
<td>263 0</td>
<td>129-7</td>
</tr>
<tr>
<td>1949</td>
<td>248-6</td>
<td>91 5</td>
<td>8 9</td>
<td>272 0</td>
<td>134-0</td>
</tr>
<tr>
<td>1950</td>
<td>259-7</td>
<td>101 3</td>
<td>11-6</td>
<td>285-1</td>
<td>152 8</td>
</tr>
<tr>
<td>1951</td>
<td>260 1</td>
<td>120-0</td>
<td>10 6</td>
<td>290 8</td>
<td>179 6</td>
</tr>
<tr>
<td>1952</td>
<td>267 6</td>
<td>115-9</td>
<td>13-6</td>
<td>293 2</td>
<td>173-1</td>
</tr>
<tr>
<td>1953</td>
<td>259-7</td>
<td>117-9</td>
<td>19-7</td>
<td>307 0</td>
<td>179-4</td>
</tr>
<tr>
<td>1954</td>
<td>298-2</td>
<td>123-4</td>
<td>24-5</td>
<td>322-9</td>
<td>197 2</td>
</tr>
<tr>
<td>1955</td>
<td>291-0</td>
<td>145-8</td>
<td>31-4</td>
<td>316 1</td>
<td>225-0</td>
</tr>
<tr>
<td>1956</td>
<td>290-9</td>
<td>144-6</td>
<td>33 1</td>
<td>319 6</td>
<td>231-8</td>
</tr>
</tbody>
</table>

**Note.** Column (2) includes Current, Deposit and Other Accounts within the State.


\(^{27}\) No 22 of 1942, s.50, s.s (1).
banks and the National City Bank. Table II shows the proportion loans and advances bear to deposits, similarly for Government bills and investments combined, and the proportion total assets within the State bear to total liabilities within the State.

**TABLE II**

*Selected Assets within the State as a Percentage of Deposit and Total Liabilities within the State.*

<table>
<thead>
<tr>
<th>Quarter ended December</th>
<th>Loans and Advances to Deposits %</th>
<th>Government Bills and Investments to Deposits %</th>
<th>Total Assets to Total Liabilities %</th>
</tr>
</thead>
<tbody>
<tr>
<td>1938 ...</td>
<td>40.9</td>
<td>5.7</td>
<td>53.7</td>
</tr>
<tr>
<td>1946 ...</td>
<td>23.1</td>
<td>3.6</td>
<td>34.8</td>
</tr>
<tr>
<td>1947 ...</td>
<td>34.5</td>
<td>3.7</td>
<td>46.6</td>
</tr>
<tr>
<td>1948 ...</td>
<td>37.2</td>
<td>4.2</td>
<td>49.3</td>
</tr>
<tr>
<td>1949 ...</td>
<td>36.8</td>
<td>3.6</td>
<td>49.2</td>
</tr>
<tr>
<td>1950 ...</td>
<td>39.0</td>
<td>4.5</td>
<td>53.6</td>
</tr>
<tr>
<td>1951 ...</td>
<td>46.1</td>
<td>4.1</td>
<td>61.8</td>
</tr>
<tr>
<td>1952 ...</td>
<td>43.3</td>
<td>5.1</td>
<td>59.0</td>
</tr>
<tr>
<td>1953 ...</td>
<td>41.7</td>
<td>7.0</td>
<td>58.4</td>
</tr>
<tr>
<td>1954 ...</td>
<td>41.4</td>
<td>8.2</td>
<td>61.1</td>
</tr>
<tr>
<td>1955 ...</td>
<td>50.1</td>
<td>10.8</td>
<td>71.3</td>
</tr>
<tr>
<td>1956 ...</td>
<td>49.7</td>
<td>11.4</td>
<td>72.6</td>
</tr>
</tbody>
</table>

Table I as a whole shows a pattern of almost continuous expansion of business within the State. Over the ten year period from the end of 1946 to the end of 1956 deposits increased by £66.3 million or by 29.5 per cent.; loans and advances by £92.7 million or by 179 per cent.; Government bills and investments by £25.1 million or by 314 per cent.; total liabilities by £74.0 million or by 30.1 per cent. and total assets by £146.4 million or by 171 per cent. The contrast between the growth in liabilities, whether in the form of deposits or total liabilities, which is relatively slight, and the enormous growth in assets, whether in part or total, is striking.

Table II puts the data of Table I in a slightly different form. Between the December quarter 1946 and the December quarter 1956 loans and advances as a percentage of deposits increased from 23.1 per cent to 49.7 per cent.; Government bills and investments from 3.6 per cent. to 11.4 per cent., and the total assets as a percentage of total liabilities from 34.8 per cent. to 72.6 per cent.

Now it might be said, with some justification, that the post-war expansion of the banks' assets and liabilities could be seen in better perspective if we compared the post and pre-war positions. Taking the end of 1938 as our pre-war base we find that the pre-war relationship between loans and advances, and deposits, and between total assets and total liabilities is almost restored by 1950. However, the position has changed considerably since then. Loans and advances as a percentage of deposits have grown from 39.0 per cent. to 49.7 per cent., total assets as a percentage of total liabilities from 53.6 per
cent to 72·6 per cent. In fact since 1950 loans and advances have increased by £43·3 million, an increase of 42·7 per cent. The corresponding figures for total assets are £79 million, a 51·7 per cent increase. It is interesting to compare these figures with those of the London clearing banks from 31st December, 1950, to 31st December, 1956, their advances rose by 16·4 per cent, and their total assets by only 4·6 per cent, something of a contrast to the Irish situation.

The figures for Government bills and investments partly indicate the extent to which Government borrowing is being financed by the banks. It does not do this completely because advances to the Government are not included, though they are included in the total figures for loans and advances. It should be said that Government borrowing on bills and by way of advances fluctuates considerably and tends to be fairly high towards the end of the calendar year, and that therefore our figures are slightly higher than they would be on an average basis. Notwithstanding this it can be said that Government borrowing, particularly since 1951, has directly contributed to the creation of credit within the State.

The other side of this picture of the banks' assets within the State growing at a much quicker rate than their liabilities within the State is a fall in their net external assets. Table III shows both the level of the banks' net external assets and the change from year to year as well as the Current Account deficits in the balance of payments.

**TABLE III.**

*Net External Assets of Banks and Current Account Deficit in Balance of Payments.*

£ million

<table>
<thead>
<tr>
<th>Year</th>
<th>(1) Banks' Net External Assets (December)</th>
<th>(2) Changes in Banks' Net External Assets</th>
<th>(3) Current Account Deficits</th>
</tr>
</thead>
<tbody>
<tr>
<td>1946</td>
<td>159·5</td>
<td>-19·5</td>
<td>29·8</td>
</tr>
<tr>
<td>1947</td>
<td>-</td>
<td>-8·1</td>
<td>19·6</td>
</tr>
<tr>
<td>1948</td>
<td>140·0</td>
<td>8·3</td>
<td>9·7</td>
</tr>
<tr>
<td>1949</td>
<td>131·9</td>
<td>-13·3</td>
<td>30·2</td>
</tr>
<tr>
<td>1950</td>
<td>128·9</td>
<td>-17·3</td>
<td>61·6</td>
</tr>
<tr>
<td>1951</td>
<td>109·6</td>
<td>10·3</td>
<td>8·9</td>
</tr>
<tr>
<td>1952</td>
<td>127·3</td>
<td>7·4</td>
<td>7·0</td>
</tr>
<tr>
<td>1953</td>
<td>121·3</td>
<td>6·0</td>
<td>5·8</td>
</tr>
<tr>
<td>1954</td>
<td>85·7</td>
<td>-35·6</td>
<td>35·5</td>
</tr>
<tr>
<td>1955</td>
<td>88·4</td>
<td>2·7</td>
<td>14·4</td>
</tr>
</tbody>
</table>

Sources

Col 2 from Central Bank Report for 1956 Table 21 p 30, except, figure for 1956 which is derived from Table V of the Central Bank Quarterly Statistical Bulletin, January 1957


**Source** Monthly Digest of Statistics No 62, Feb 1951 Table 145 and ibid, No 133, January 1957 Table 142
The banks' net external assets have fallen by £71.1 million over the ten year period, a 44.6 per cent decrease, whilst the cumulative deficit on current account in the balance of payments amounted to £222.2 million. Without going into the question in detail, though it will be necessary to look more closely at the last couple of years, it is interesting to see roughly how the difference was financed. A large part of the deficits on current account have been covered by loans and grants under the European Recovery Programme and by the realisation of external assets by Government Departments. Using the balance of payments statements in the Irish Trade Journal, it can be found that the assistance from these two categories was £46.9 million and £26.2 million respectively; a total of £73.1 million. For the rest there has been a net realisation of private holdings, some capital inflow to companies and a large credit item included under the miscellaneous "Other Capital Transactions." On the other hand there has been a net acquisition of external assets by the Central Bank, but more of this presently.

Let us look a little more closely at recent developments. In 1955 there was a current account deficit of £35.5 million in the balance of payments and the net external assets of the banks dropped by £35.6 million over the year; almost exactly half the drop in the banks' net external assets over the last ten years. At the same time there was a net increase of £21.7 million in the banks' assets within the State. The main increases were £17.9 million in loans and advances and £12.5 million in Government bills. These increases were partly offset by a drop of £8.7 million in cash. The decrease in the cash item is probably all explicable by the staff difficulties of the banks at the end of 1954 and the piling up of work that entailed. Cash was abnormally high at £32.6 million, whereas a year before it had been £19.6 million and a year later was £23.9 million. In other words the £8.7 decrease is probably spurious and understates the increase in assets within the State. The increase in Government bills is apparently partly due to the postponement of the Government's usual autumn loan until February 1956. However, whatever the reason, it contributed to the creation of credit within the State. So in 1955 we have the combination of a large expansion of credit by the banks and a current account deficit in the balance of payments of £35.5 million, almost exactly offset by a loss in the banks' net external assets of £35.6 million.

In the following year, 1956, the current account deficit was £14.4 million and the banks' net external assets increased by £2.7 million. The net increase in the banks' assets within the State was £4.3 million. The main increases were £1.3 million in cash, £2.1 million in loans and advances, £5.1 million in Government investments, £0.4 million in other investments and £2.5 million in acceptances. Government bills dropped by £6.8 million and other bills by £0.6 million. In other words, though there was some growth in the banks' assets within the State during 1956 it was much smaller than during 1955.

Particularly in the light of 1955 experience, how did the banks' net external assets increase if there was a current account deficit of £14-4 million in the balance of payments? We find that during 1956 there was a net realisation of £17-8 million of external reserves by the authorities of departmental funds as well as £2-9 million by the Central Bank. Other things being equal this must have been of the greatest consequence to the banks and looks extremely like official support.

We must now turn to the interest rate policy of the banks in the last few years. It was stated earlier that for many years the banks had traditionally determined their interest rate policy in relation to rates in England. The procedure had generally been for the Irish banks to alter their rates with every alteration of the discount rate of the Bank of England. Roughly, the Irish banks appear to have had in the past a minimum of 5 per cent. for ordinary overdrafts and subject to this, generally, but not always, a margin of 2 per cent. between Bank of England rate and their ordinary overdraft rate. (This seems to be the policy still followed by the banks in Northern Ireland.) This practice of more or less automatic adjustment of rates by the banks ceased to apply with the increase in the Bank of England rate from 3½ per cent. to 4½ per cent. in February 1955. The ordinary overdraft rate was maintained at 5½ per cent., whilst "normally" it would have risen to 6½ per cent., the rate on deposits of less than £25,000 was held at 1 per cent., though significantly enough the rate on deposits of more than £25,000 was increased from 1¾ per cent.

\[ \text{TABLE IV.} \]

\begin{tabular}{|c|c|c|}
\hline
(1) & (2) & (3) \\
End of & Notes & External \\
year & outstanding & Assets \\
\hline
1947 & 45-2 & 45-7 \\
1948 & 47-1 & 47-7 \\
1949 & 51-1 & 64-9 \\
1950 & 56-9 & 81-5 \\
1951 & 60-9 & 67-0 \\
1952 & 65-0 & 72-0 \\
1953 & 69-5 & 77-3 \\
1954 & 75-4 & 86-6 \\
1955 & 76-3 & 80-2 \\
1956 & 75-3 & 77-3 \\
\hline
\end{tabular}

Sources: Central Bank Reports for years 1947-55. For 1956 the figure for notes is an average of December 1956, and the figure for external assets takes account of the change shown in the Balance of Payments Statement, T.J.S.B., March, 1957.

32 See also 1938 Banking Commission Report, pp 194-199
33 Bank of England rate had been increased from 3 per cent to 3½ per cent. on Jan. 27th 1955, but the Irish banks made no alteration in their rate on ordinary overdrafts which remained at 5½ per cent.
cent. to 2½ per cent. These rates were held throughout 1955. But from the 1st January, 1956, the ordinary rate on advances was raised to 6½ per cent. and the rate on deposits of less than £25,000 to 1¼ per cent.; the rate on deposits of more than £25,000 was not changed. These appear to be the rates still in force despite the subsequent changes in British rates.

The break from the usual adjustment policy was made following a request from the Minister for Finance who told the banks through the Irish Banks’ Standing Committee that the conditions underlying the increase in Britain did not operate in the Republic at the time. We are told that the banks recognised this and agreed to make no change. Perhaps the Minister and the banks misjudged the position because of the relatively favourable out-turn of 1954. In any event we have seen something of the course things took in 1955.

Little or nothing has been said so far about the part that the Central Bank has played in the post-war period. This must now be rectified. First of all some facts. Table IV shows the amount of Legal Tender Notes outstanding as near as possible to the end of each calendar year and the external assets held by the Central Bank on 31st December in each year.

Every year except 1956 shows an increase in note issue over the previous year and consequently we would expect, other things being equal, a roughly similar pattern—though not necessarily exactly the same—in external assets. In fact, however, the 1949–51 figures are affected by both lodgements and withdrawals of the American Loan and Grant Counterpart Funds. It seems as if part of these funds, possibly of the order of £6 million, was still helping to augment the external assets of the Central Bank after 1951. Be that as it may, we see from Table IV that in 1955 and 1956 the external assets of the Central Bank fell by £6.4 million and £2.9 million respectively, notwithstanding the almost stationary level of the note issue over the two years. To the extent that the difference between the notes outstanding and the external reserves indicates the volume of sterling available to the General Fund, and this seems plausible, it has been greatly depleted. Of course, the loss may not be permanent.

During 1955, it seems for the first time, the Central Bank used the resources of the General Fund for banking purposes. The Bank “re-discounted Exchequer Bills and Bills of Exchange which had been discounted by the associated banks.” And a little earlier in the Report we read “the heavy demands upon the banks’ external resources involved a deficiency in net external holdings of the commercial banks which had to be relieved by the Central Bank.” This would seem to imply a serious depreciation in the value of the net external assets of the banks. It is a moot point if the sterling support given by the Central Bank is temporary or of a more or less permanent nature. If the support took the form or partly took the form of a transfer of some remaining Counterpart Funds to the Government accounts with the banks then it would be a net gain of sterling

35 *See* Central Bank Report 1956, p. 47, par. 65.
by the banks. If it only took the form of discounting bills, and if, when these are paid off, it ultimately means a transfer of sterling to the Central Bank, then, of course, the Central Bank may re-acquire its sterling. One thing is clear, it had not re-acquired the lost sterling by the end of 1956.

Finally we must look at the Central Bank’s publications, in particular the views expressed in them. Running through the Central Bank Reports for the last eight or nine years one finds the same themes recurring again and again. Attention is forcefully drawn to the growing volume of Government expenditure, both Central and Local Government, that much of this expenditure has been of a “non-productive” character and therefore contributes little or nothing to a solution of the current account deficits in the balance of payments. The Central Bank has called for restraint on numerous occasions. The following appeared in its 1949 Report and can be taken as typical: “The course of budget development has reached a point where it is greatly hoped that measures of restraint will be accepted as a matter of urgency. In particular the scope and scale of State capital projects raises questions which have a vital bearing on Irish monetary stability. The avoidance of inflation in the methods adopted to finance these projects is a consideration of high importance.” In its 1956 Report it was still worried about the problem of excessive demand in relation to available resources and the form which investment was taking.  

A related and continuing problem has been, of course, the running down of external assets and the incurring of external debt. In its 1956 Report we find this statement: “The net value of all our external assets represents a slender margin of safety in view of the great fluctuations in our external trade, of the high volume of mobile external funds here and of our contractual liabilities.”

What has the Central Bank got to say about the question of credit creation by the banks? In its 1951 Report it stated, “Rigorous restrictions of bank credit for non-essential and less urgent purposes is now imperative if the banks are to be in a position to afford reasonable accommodation in those directions which are most in accord with the public interest.” And in its 1956 Report appears the following: “Credit has been made widely and freely available and has been used to finance imports on a scale which the export capacity of the economy plainly cannot sustain.” However, it is very careful to state a few lines later that this “...is not intended as an adverse comment on bank credit policy since the expansion of purchasing power was itself a consequence of the underlying economic developments...” But it must be said that this reads oddly in the light of later statements. For instance: “It is manifestly the commercial banks’ obligation to keep the amount of credit granted at a level consistent with their continued ability to provide the external finance—in the shape of drafts on their external assets—arising out of the use of deposits

---

37 See Central Bank Report, 1956, p. 34 et seq.
38 Ibid., p 44, par 59.
39 Ibid., 1951 p 16, par 20
40 Ibid., 1956 p. 35, par. 51.
lodged with them or out of the use of credit granted by them." This comes in the same paragraph as the disclosure that the Central Bank had to give the banks support during 1955.

What does all this amount to? We have seen how the 1938 Banking Commission judged the position as it then was, the factors which caused them anxiety, that they called for a closer co-ordination of Government economic policy and monetary policy; that they believed that the large holdings of net external reserves by the banks might allow an unbalanced position to persist for a dangerously long period. Notwithstanding this they did not attempt to provide a Central Bank that might have exercised some control over the situation. Yet their fears have been amply vindicated in the post-war period.

We are told on the authority of the Central Bank that the State has pursued an expansionary policy contributing to inflation within the State and a running down of external assets. That on the whole it has pursued this policy irrespective of its monetary repercussions seems to be an unavoidable conclusion from the statistics reviewed above. The banks, and here we may be too kind, have followed a liberal credit policy, apparently misjudging the position in 1955 even in relation to their responsibilities to their depositors and shareholders, apart from the public interest which obviously requires the careful husbandoing of external assets.

It would seem that the Central Bank would have liked to pursue for many years past a monetary policy that would have avoided such prodigal running down of external assets, but could not. It has been as a voice "crying in the wilderness" trying to exercise "moral suasion" on all parties, but without much success. This is not to deride its efforts. Indeed I believe that it deserves the highest praise for its courageous and independent assessment of the position.

The Central Bank has studiously avoided criticising the banks, keeping its strictures for Government policy. For the Central Bank the latter was, in the main, the active force, if not the only one. The banks only helped to provide the finance for expansion in general. I think we must accept this last proposition, without prejudice to the others. It is not the function nor can it be expected of a competitive commercial banking system to pursue of its own accord a monetary policy that may conflict with its own legitimate interests. Its primary responsibility is to its depositors and shareholders and its main concern is, in the widest possible sense, with sound commercial propositions.

If expansionary economic policies are still to be pursued, and few would deny that real economic development is desirable, then an integrated monetary system is an essential prerequisite. At the same time there is a paramount need for the co-ordination of monetary and general economic policy. In the next section I will try to show how a more effectively integrated monetary system could be brought about by certain alterations of the present one. It would also, I think, make for closer co-ordination of general economic policy.

41 Ibid., p. 40, par. 55.
Suggested Alterations

The basic problem is to adopt the present system so that the Central Bank has greater control over general credit policy. There are a number of ways of bringing this about and of exercising control over a monetary system where there is a relatively undeveloped capital market. The Irish Problem is, however, complicated by the fact that nearly all the banks operate outside the Republic as well as inside. It would seem that this difficulty could only be overcome by a complete separation of the banks' activities within and outside the Republic. The difficulties involved in bringing about separation will be considered as the discussion proceeds. But to begin with, I shall concentrate on outlining a system over which the Central Bank would have control, omitting the difficulties of transition.

Perhaps the most direct method of giving the Central Bank control over the monetary system, given the Irish position, would be to centralise the net external assets of the banks in the Central Bank, giving the banks interest-earning deposits in exchange, and by introducing reserve ratios. The question of interest payments on these deposits is further considered below. (It would probably be found advisable to centralise the remaining sterling holdings of the Government department in the Central Bank, but we shall not discuss this any further on this occasion.) At the end of 1956 the net external assets of the banks amounted to £88.4 million—accepting such figures for the amount as a basis for the discussion. This amount, except for working sterling balances—to be considered below—would become part of the sterling holdings of the Central Bank. There would be, of course, at the same time an equal increase in the deposit liabilities of the Central Bank.

One of the primary responsibilities of the Central Bank would be to maintain a given exchange rate with sterling; unless of course, and this seems unlikely, it was desired to have a fluctuating rate of exchange. Granted the aim is to maintain parity with sterling it would seem that this could best be done by the Central Bank being always ready to buy or sell the Irish pound at the given rate through its account at the Bank of England and in conjunction with the commercial banks. At present these banks maintain balances with their correspondents in London, an arrangement that need not be disturbed, provided that these balances—which may be called Republican balances to distinguish them, where relevant, from balances held in relation to the banks' activities outside the Republic—did not exceed a certain maximum. As now, correspondents could continue to collect and pay cheques or any other instruments drawn on Irish banks distinguishing between Republican and other balances. If the Republican balance of a bank with its correspondent fell, it could be augmented by a transfer from the Central Bank's balance at the Bank of England to the particular bank's balance with its correspondent and vice versa. Offsetting movements would be made at home in the bank's balance at the Central Bank.

Granted the external reserves of the Central Bank are not allowed to fall so low as to impair confidence, these arrangements should maintain the Irish pound at parity and prevent the development of exchange points between the Irish pound and sterling. The Central Bank's
balance at the Bank of England would still need to be used to continue the present arrangement whereby Central Bank notes presented there are payable in sterling.

Let us now consider some of the implications of the postulated change and the question of the control of the system. One obvious implication is that the present method of controlling the note issue would have to be altered. Apart from their working balances with their London correspondents the banks would have no sterling to exchange additional notes. There would, in fact, appear to be little or no reason for retaining the present distinct Legal Tender Note Fund which could become part of the General Fund. In other words the General Fund would include all the external assets of the Central Bank. If the banks required additional notes they could obtain them in exchange for their deposits at the Central Bank. In theory it would not be necessary to limit the note issue of the Central Bank or to back it by assets of any specific kind. However, if it was felt that there should be some restraint on the note issuing powers of the Central Bank there could be a statutory limitation similar to that on the Bank of England.

Naturally the postulated changes would mean some alterations in the banks' current practices. Clearing balances between the banks, arising from their activities within the State, would be settled by drafts on the Central Bank. Suppose, however, that the Royal Bank had cheques for collection against the Bank of Ireland in Northern Ireland. One way to settle this would be by a transfer of sterling from the Northern Ireland Bank of Ireland's balance with its London correspondent to the Royal Bank's Republican balance with its London correspondent. It is not suggested that this is the only way to do things and doubtless the banks could be relied upon to discover the best method. It does, however, illustrate an implication of the principle of separation of the banks' activities within and outside the State.

Let us now turn to the question of the Central Bank's control of the internal monetary system. It would be essential that the Central Bank should become Government banker in the interests of the closest possible integration of economic and monetary policy. This might give rise to some difficulties for the Central Bank if the pattern of Government receipts and payment was irregular. The irregularity would alter the cash basis of the system. However, the difficulties need not be exaggerated and granted its weapons of control were sufficiently sensitive and flexible it should be able to cope with the situation. Should the Government be allowed to borrow directly from the Central Bank in the form of "Ways and Means" advances? On the face of it there seems little reason why not, granted the Central Bank's powers were sufficiently flexible. There is, however, a good deal to be said for obliging the Government in general to borrow short term from the banks. For one thing it would give the latter a wider choice for the distribution of their assets.

What would give the Central Bank a flexible and sensitive method of controlling the system? The Central Bank has already got the power to engage in rediscounting and open-market operations. These should be retained but would obviously be quite inadequate in the
circumstances of the Republic. For one thing the Central Bank would have little or no Irish assets to start with and would have no means of engaging in open market operations apart from there being no money market outside the banks. At the same time the banks would be extremely liquid with their large deposits at the Central Bank and could pursue an unrestrained expansionary policy. A solution, which I have already suggested, would be variable minimum reserve ratios. The banks would be required to keep minimum reserves in relation to their deposit liabilities within the State, the ratio being decided by the Central Bank. This in a sense is only an adaptation of parts of the Central Bank Act, 1942, though I think for somewhat different reasons than were there envisaged.

What should constitute these reserves? With the idea of giving the banks as much flexibility as possible in the distribution of their assets there seems no reason why they should not be allowed to include all balances with the Central Bank, till-money, consisting of notes and coin within the State, and the Republican balances with their London correspondents. The term "all" balances with the Central Bank is used because it might be found advisable for the banks to have two kinds of balances, a special interest earning balance, or deposit as we have called it, and a non-interest earning balance or current account. If the banks were paid interest on all their balances with the Central Bank the public might demand the same from them. Otherwise there might be no need for two kinds of accounts.

The discussion has been carried on implicitly in terms of uniform reserve ratios. It has been found, apparently, that non-uniform ratios lead to charges of discrimination against the Central Bank. Such has been Australian experience. With uniform ratios there is a need for flexibility which can be exercised by the Central Bank in favour of any individual bank. This would almost certainly be necessary at the establishment of the system when the banks might have transferred different proportions of sterling to the Central Bank. Flexibility could be obtained in at least two ways. The Central Bank could re-discount suitable bills for any bank, at a price, or make advances at penal rates to any bank. Once the system was established the Central Bank might find it convenient to purchase securities on the open market in such a situation. The Central Bank's re-discount rate or penal advance rate, which might both be the same, would become the pivot of interest rates within the system. The banks would find it necessary to determine their rates in relation to them. The onus and the odium for monetary policy would rest on the Central Bank.

It is necessary now to take up some of the practical problems of the transition to such a system. These involve the separation of the banks' activities within and outside the Republic, the valuation and form of the banks' net external assets to be transferred to the Central Bank and the question of the banks' earnings; more especially

---

interest payments on their deposits at the Central Bank. It must be emphasised that no claim is made to provide a complete solution to these difficult problems.

In the system outlined above separation of the banks' activities within and outside the Republic would be essential to its satisfactory working. However, the problem cannot be left there. If a bank is to operate both within and outside the Republic and yet be completely separate it would seem that it must, in effect, become two separate institutions. This would require a division of capital and reserves for the banks concerned. The basis of division could probably be based on relative volume of activity within and outside the Republic. The banks continuing to operate in the Republic would be incorporated there. This would mean a division of some banks' shares into two kinds, Irish and others. Shareholders would have their holdings divided on the basis of the division of the individual bank's activities. An alternative might be to form a holding company to hold the separated shares giving the former shareholders shares in the holding company which might be incorporated either within or outside the Republic. The separated banks would have to publish separate balance sheets and declare separate dividends.

Some banks rather than undergo such a surgical operation might prefer to cease operations outside the Republic. This might be true of the smaller banks or those whose interests outside the Republic represent a very small proportion of their total activities. It might be possible, alternatively, to arrange exchanges of branches between banks which would decide to confine their activities to either the Republic or elsewhere. Or again certain divided banks might decide to amalgamate to become more viable units.

The next question we need to consider is the valuation and form of the banks' net external assets. What are the net external assets of the banks? It is not enough to say the figures shown in Column 2 of Table III above, useful though these are for tracing the trend of events over the years. The first thing to do is to determine liabilities and where they are located. Assuming that division of the banks would be the typical case and supposing that the question of capital division would be satisfactorily achieved, it remains to determine the other liabilities and their location. It would seem that deposit liabilities and all others except reserves could be determined and located easily enough. The real difficulty would be the valuation of reserves. Once valued they might be divided on the same basis as capital. This question of valuation of reserves is necessarily tied up with the valuation of assets.

Reserves appear to be a book value, a residual. At any point of time in the past they must have had a certain value and there is a record of how they have been determined, both hidden and declared. However, what we would want would be their value at a future point of time when the postulated changes might be brought about. Between the last valuation of assets and reserves, and what may be called the appointed day, each bank would undergo certain financial experiences. There might be some bad debts, windfall gains, investment depreciation or appreciation and so forth. The point is that with full knowledge it ought to be possible to get a valuation of assets.
and consequently of reserves If this is granted and we knew the location of the liabilities then we could get a determinate figure for net external assets

This, however, is only part of the problem What assets are to be exchanged for deposits with the Central Bank? Should the valuations arrived at above be used? And if so, what would happen if investments were valued at either more than or less than their current market prices, but granted they were below redemption prices? The fairly reasonable assumption is made that all investments have redemption dates Every consideration would have to be given to those banks continuing to operate separately outside the Republic. Full regard would have to be paid to their need for both liquid assets and for more profitable assets, particularly for a fair share of assets with potential capital appreciation.

Certain sterling assets could be ruled out as being virtually incapable of transfer. Such are loans and advances, premises, acceptances and probably some other miscellaneous assets. These would have to remain the property of the bank operating outside the Republic. This leaves cash, money at call, bills and investments. Let us suppose that the valuation of assets arrived at above on the appointed day were such that they were above market prices but below redemption prices. Other possibilities would seem to be more amenable. Now the banks would not want to lose the prospects of capital appreciation involved in some of these assets. There is I think a way out of this difficulty. The Central Bank might announce that it would in the first instance only create deposits to the extent of the balance sheet valuations arrived at above in the transfer of assets to itself. But that over the life of assets in which there would be capital appreciation it would pay such appreciation to the banks concerned. This would give a bank an equitable division between its two parts. It would be in the interests of each bank to achieve this. This should make the transfer of net external assets possible. In the aggregate there are sufficient assets of the "right" kind to allow this. For the December quarter 1956 these amounted to some £175 million while net external assets on the "crude" basis amount to £87.7 million.

There is reason to believe that it would not put an intolerable strain on the Central Bank to allow capital appreciation over the life of assets transferred from the banks. This is because the assets of the Legal Tender Note Fund are relatively liquid. Of total assets of some £73 million on 31st March, 1956, over £33 million was in cash or securities with less than 12 months to maturity. It would be very unlikely that the Central Bank would have to liquidate depreciated assets unless, of course, a severe crisis developed. It would be its job to do everything possible to see that this did not happen.

Finally, how would the postulated changes affect the earnings of the banks? It would be impossible and undesirable to be dogmatic about this. For one thing it is unlikely that the structure of assets of the banks under such a system would be stationary and it would necessarily be very different from that to-day. But there are grounds

43 Quarterly Statistical Bulletin, Central Bank, January 1957, Table V, p 4
44 Central Bank Report 1956, p 47
for thinking that the banks' earnings need not suffer. The Central Bank could probably afford to pay a rate of interest on the banks' deposits which would compensate them for the loss of their earning assets. However, the Central Bank's hands could not be tied in this matter. In general the rate of interest payable on the banks' deposits with the Central Bank would have to be related to the structure of rates within the State, given the external position.

That the difficulties that would be involved in this particular problem of the change over are formidable, no one would deny. And the preceding discussion must be looked upon as a tentative inquiry into some rather technical questions. However, given the banks' co-operation and the confidence of the public, which need not and must not be disturbed, the changes could probably be brought about relatively smoothly.

If the postulated system was established it would, I think, put the Central Bank into a position of authority and great responsibility for the management of the monetary system. The authorities would be forced to co-ordinate economic and monetary policy. This indeed might demand great forcefulness on the part of the Central Bank, but there are grounds for optimism in this respect. The Central Bank would be in a position to take concrete action, subject always to the limitations imposed by the external economic environment. The banks could pursue their private aims within the framework of such a system. Wild claims, however, should not be made for the postulated system. It promises no quick and easy road to economic wealth. To begin with, the virtues of the postulated system might be more negative than positive in preventing the further loss of external assets and in avoiding the consequences of such loss. This would be no mean achievement.

DISCUSSION.

Mr. Patrick Lynch, in proposing the vote of thanks, said. Apart from the invaluable publications of the Central Bank critical commentaries on Irish commercial banking are few and even the data sometimes elusive. Although there is a great deal of public discussion about banking and credit, much of it is often inadequately informed or misinformed. Misunderstandings and misconceptions are allowed to go unanswered. There are plenty of constructive things which might be said and are not said by those in possession of the facts, and too often unfounded criticisms are permitted to flourish in silence. For these reasons an authoritative paper such as that presented by Mr. Gibson is welcome as a means of educating public opinion and stimulating discussion on real issues rather than on phantom prejudices. Apart from its responsibilities for maintaining the stability of the currency, the Central Bank has discharged with courage and independence the role of detached commentator on Irish banking. But this great public service has not always been enthusiastically appreciated.

The Irish commercial banks have deservedly earned a great reputation. They have invested heavily in Ireland especially during the past decade. They have performed their dual role of financing trade and
commerce on the one hand and helping to maintain the parity relationship between the Irish currency and sterling on the other. In recent years, however, there have been changes of more significance for the commercial banking system than is generally realised. The diminution in the country's surplus of sterling reserves has had far-reaching implications; and Mr. Gibson's paper is of the first importance because of the light it throws on some of these developments. His paper is controversial and outspoken, but it is to be welcomed on this account because too much of the informed discussion of Irish banking and credit has tended to be either esoteric or reticent and timorous.

Mr. Gibson shows that since 1955, the year in which there was last a very substantial deficit in the Irish balance of payments, a new situation has been created for commercial banking. There is now a close connection between the condition of the balance of payments and the capacity of the banking system to create credit. The connection was always there, of course, but while reserves were high its implications were obscured. The most vital issue now for Irish commercial banking is not the capacity of the system to expand credit but whether existing means for controlling and regulating its creation are sufficient to preserve the character and integrity of the system.

It is almost twenty years since the Banking Commission Reports were presented. These reports contain perennial truths whose validity continues to be underlined in the publications of the Central Bank. The principles enunciated are still right, but the facts have changed. Irish commercial banking is no longer cushioned by the very big reserves of sterling which afforded the system a flexibility in the past which is not available today. The fundamental question invoked by Mr. Gibson's paper is whether the commercial banking system is equipped to respond to the needs of the new economic situation. He has rightly raised the question of the impact of the balance of payments on internal credit policy. In so far as the level of the balance of payments must now largely determine the level of credit which the banking system can safely create, Ireland is in a condition closely resembling that which induced certain countries to leave the gold standard. These countries wanted to pursue a more independent economic policy internally. But the inference from Mr. Gibson's remarks is not that the link with sterling is inconsistent with our best interests at present. The question is whether the Central Bank can exercise sufficient power to preserve the integrity of the currency in changing conditions and whether the commercial banking system has adequate safeguards.

Responsibility for the regulation and creation of credit is diffused in Ireland between the Central Bank, the Department of Finance and the commercial banking system. This dispersal of responsibility has obvious advantages in guaranteeing the independence of the banking system, but there are disadvantages as well and Mr. Gibson is very interesting in his discussion on the question. A centralisation of control over the creation of credit might prevent the recurrence of the serious deficit which took place in 1955 in the balance of payments. But a centralisation might be hard to achieve technically without raising new problems and difficulties. It is however in the
immediate interests of the commercial banking system itself to give
careful attention and consideration to these questions. The future
of commercial banking depends on its ability to retain sufficient
sterling reserves to finance normal trading transactions and to provide
a base for the creation of domestic credit. It is not evident at first sight
that a system, in which eight associated banks which are commercial
rivals and which in business matters act independently, is likely
to operate with sufficient co-ordination to ensure that the combined
sterling reserves of its members are maintained at a level adequate
for their individual commercial requirements, and adequate as well for
the national interest. Mr Gibson reminds us that in 1955 the com-
mercial banking system received some assistance from the Central
Bank. It is relevant to ask whether it is proper that the Central
Bank should act as lender of last resort to commercial banks over
whose day-to-day activities it has no control or, indeed, direct
influence.

The centralisation of all the sterling reserves under the control of
the Central Bank would mean that the country’s entire sterling
resources would be mobilised under a single authority, and seen to
be what they really are—our foreign exchange reserves. This would
enable credit control to be co-ordinated in the Central Bank and would
give the bank more effective instruments for regulating the level
of credit than exist at present. There are great practical difficulties
to be met before any such centralisation of reserves can be contem-
plated. It is well, however, that Mr Gibson should have raised the
issue. He has given us a good deal to think about. He has given
us facts, and has without dogmatism pointed the way towards the
kind of reforms which may well be found necessary in Irish banking
in the future. He has dealt with the technical problems involved in
a very well informed and clear way, and shown that problems are
bound to arise in a commercial banking system which has the dual
role of acting as a private profit-making business on the one hand
and acting as an agent in the creation of public credit on the other.

Mr Gibson’s paper is a very timely one. The economic develop-
ment of Ireland requires a big investment programme, and there is
likely to be considerable rivalry between the interests of private and
public investment. Mr. Gibson shows that there are definite and
narrow limits within which commercial banking can help to finance
a large development programme. It is undesirable that the banking
system should undertake long-term investment tasks for which it has
not been designed. It is right, therefore, to ask whether the existing
informal machinery for the control of credit achieves sufficient co-
ordination. It may well be, as Mr. Gibson suggests, that some of
the dormant powers in the Central Bank Act of 1942, might be exer-
cised with advantage to the banking system as a whole. At the
same time it cannot be too strongly emphasised that however desirable
a reform of the banking system may be, banking reform in itself can
be no substitute for a sound national economic policy. Irish banking
is in many respects non-genres. It is deeply involved in the financing
of foreign trade. It was not designed for the purpose of financing
long-term domestic investment. The Republic is, as Mr. Gibson
says on the first page of his paper, an open economy and our banking
system, in the form in which we have inherited, is an expression of the economic environment which produced it. It is important, therefore, that the commercial banking system should not be pushed into performing tasks which it was not intended and to which it cannot readily adapt without changing its character. We must at all costs avoid the danger of damaging the capacity of the banks to perform tasks which they can discharge efficiently and adequately by imposing on the system responsibilities for which it is not equipped. Mr Gibson's paper is particularly important because it has drawn attention to the manner in which the changing economic situation of the Republic, particularly the past decade, has implications for a banking system which is naturally slow to change. There may be no need for a radical departure from the institutional framework of banking which has served the country so well for so long. But there is need for informed criticism, for authoritative analysis and comment by economists who have studied the matter as Mr Gibson has. There is need above all for careful and constructive consideration of the difficult questions which he raises. It may be unnecessary to answer these questions immediately but it is surely desirable that they should be formulated now rather than they should present themselves to our surprise before we are prepared for them. One likes to be confident that the banking system is adapting to the new economic situation which has overtaken it.

Mr G. Brock, in seconding the vote of thanks, congratulated Mr Gibson on the detail in which he had given the "historical setting" of the present monetary system of the Republic. While a great part of this ground had been covered before, Mr Gibson had brought the matter up to date for the purpose of his paper. With the author's "Suggested Alterations" however, he, Mr Brock, found himself altogether in disagreement. He thought that the keynote of the paper appeared to be the belief of the author that "the present monetary system (of the Republic) makes co-ordination unnecessarily difficult to achieve," but no evidence was given to support this belief. The problems which have arisen in the Irish economy are due to causes extraneous to the Banking System, causes which are very fully dealt with in the Annual Reports of the Central Bank. In a democratic State a Central Bank can only have such control over the monetary and financial policy of the State as Parliament is prepared to give it, and the way in which such control is exercised is usually for the Board of the Central Bank to decide. The present monetary system has the great merit of simplicity; it works well and efficiently, and one cannot but believe that this objective was very much in the forefront of the lengthy considerations given to our monetary system by the Currency Commission, and later by the Banking Commission. To replace the present system by a new one which would be difficult to administer, unsatisfactory, and almost certainly, much more costly in operation, would not make any contribution to a better relation between national Income and national Expenditure, on which all efforts must now be concentrated. The author's first paragraph on page 154 opens up a nightmare prospect of the kind of irrational changes which the adoption of the proposals in the paper would involve. They would introduce unnecessary complications and difficulties as between
the Republic, Great Britain, and N. Ireland; would achieve no beneficial results, and they would be an added irritant to those already arising out of partition in this small island. Incidentally these proposals for effecting changes in the present monetary system are not new.

Again, such control as the Central Bank wishes to exercise over the Commercial Banks can be, and is being, achieved either by consultation, or, if the Banks were not prepared to defer to the views of the Central Bank, by the latter exercising the considerable powers which it already possesses. So far it has never had to use these powers, and it is quite clear from the Central Bank Reports that at no stage have the Commercial Banks attempted to pursue a policy not in the public interest. Further it can be said that with confidence that there is no evidence, as is suggested on page 150 of the paper, that the Banks have at any time been unmindful of their responsibilities to their depositors and shareholders. On page 149, paragraph 4, the author seems to find a conflict in the statements which he quotes from the Central Bank Report for the year ended 31st March, 1956, but there is in fact no conflict. The statements that credit "has been used to finance imports on a scale which the export capacity of the economy cannot sustain", that this "is not intended as an adverse comment on Bank credit policy since the expansion of purchasing power was itself a consequence of the underlying economic developments," and that "it is manifestly the Commercial Banks' obligation to keep the amount of credit granted at a level consistent with their continued ability to provide the external finance" are not inconsistent, and the Commercial Banks carried out the obligation to which reference is made. The author proceeds to mention that these statements come in the same paragraph as the disclosure that the Central Bank had to give the Banks support during 1955. But it is surely quite clear that such assistance as was provided by the Central Bank to the Commercial Banks was given by the Central Bank in pursuance of what it considered the correct policy to pursue at the time and in the circumstances as which such action was taken. It could quite obviously have decided not to take such action, or to take alternative action, with consequential results on the Banking system. The reference in paragraph 55 of the Central Bank Report to "a deficiency in net external holdings of the Commercial Banks" should not be taken out of the context of the whole of that paragraph, which shows quite clearly that "deficiency" referred only to the reserve ratio which the Banks felt they must maintain against their current and deposit account liabilities.

The fundamental drawback of a paper such as this is that it tends to make people think about the wrong things, and to take their eyes off the real conditions by which the economic prosperity of this country must be achieved, viz. sound government financial policies; economies in current expenditure; a balanced Budget; capital expenditure to be reasonable in relation to the national income and savings, and devoted to productive purposes; the necessity for increased efficiency in agriculture and industry; the direction of production to articles suitable for export at the right prices, adequate marketing arrangements, and the necessity for restraint in monetary awards in relation to pro-
duction. These are the things that matter—not monetary devices. If one is considering the holdings of Foreign Exchange by the Banking system it is the amount held by the system, and the trend of this amount which matters, and not its distribution between the Central Bank and the Commercial Banks.

To contemplate a complete separation of the Banks' activities within and outside the Republic would not be practicable, except on the basis that Banks which only operate to a comparatively small extent in either the Republic or N Ireland should dispose of their smaller interests and confine themselves to one or other area. Such disposal to another Bank should be for cash for physical assets, advances, etc less liabilities on Current and Deposit Accounts; there could be no split of Capital or Shareholders or Reserves, while local staffs and the service and pension obligations to them would have to be taken over and, except in so far as it was necessary to realise them for the purposes of sale or acquisition, the Sterling Assets of the seller, as well as of the buyer, would remain with such seller or buyer respectively. That is a proposition which could be handled without any change in the monetary system, but what benefit would be achieved, except possibly the long term one of a contraction in the number of Bank Offices and a reduction in the overhead charges of the system as a whole.

The author visualises on page 151 that balances with London correspondents need not be disturbed, but that there would have to be a division between Republican Balances and N Ireland Balances. The incidence of a surplus or a deficiency on one of these accounts could not presumably be set off against a deficiency or surplus on the other. The Republican Balance would have to be covered by transfer from the Central Bank, while the N Ireland Balance would be covered in the normal way—"Money at Call," as at present. These arrangements would in my view involve needless trouble and expense, for which the Irish Banks would have to foot the bill. At the foot of page 152 the author states "There is, however, a good deal to be said for obliging the Government in general to borrow short-term from the Banks." But under his proposals the Banks would have no Reserves other than in the Central Bank, and the suggestion, if implemented, would merely mean a transfer from one account to another in the Central Bank. He proceeds further—"For one thing it would give the latter (the Banks) a wider choice for the distribution of their assets." That, however, is a choice which has never been lacking! Again, later on, he states that "... the Banks would be extremely liquid with their large Deposits at the Central Bank and could pursue an unrestrained expansionary policy." This seems to convey the existence of some magic wand that will turn a Bank's Deposit with the Central Bank into a veritable widow's cruse of oil! The old theory that Advances create Deposits was blown sky high here between 1954 and 1956, when Loans and Advances, Government Bills and Investments, other Domestic Bills and Investments increased by £32.6 mns, but Current and Deposit Accounts fell by £7.3 mns at the same time. So much for the "expansionary" policies pursued by the Banks in 1955 and 1956, in which obviously most of "the expansion went overseas".
The last point I wish to make on the proposals is that if the Banks were "willy nilly" subjected to increased costs either directly or indirectly in any scheme of co-ordination or integration without savings to offset them there would be no alternative open to them but to pass these increased costs on to the public. The proposals outlined have no visible savings in them.

I like the author's admission on page 152 "that the Banks could be relied upon to discover the best method," and I suggest that this is what they have in fact done, and that their methods have stood the test of two severe examinations by Commissions of experts.

Mr W A Collins: I should like to join with the proposer and seconder of the vote of thanks in appreciation of the research and study devoted by Mr Gibson to the preparation of his paper.

The statement on page 139 that our legal tender notes were made redeemable in British legal tender in Dublin and in London could lead to misunderstanding. While the notes must be so redeemed at the London agency there is no legal obligation to redeem in Dublin, but the Central Bank has the option to do so "whenever and to such extent as it thinks fit."

Reference to the Note Reserve Fund now called the Currency Reserve, on page 140 brings to mind one of the most important provisions of the Acts which is generally ignored. That is, that as well as a sterling backing the legal tender note has also the backing of the State. Should the monies available for redemption in the Legal Tender Note Fund and the Currency Reserve not be sufficient any deficit will be made up out of monies advanced out of State funds.

While I agree with Mr. Gibson that amendment is desirable in our monetary system I consider his proposals unnecessarily drastic and that a number of the alterations he suggests could be dispensed with.

Sufficient control is possible by constituting the Central Bank a bankers' bank for the settlement of all external transactions and through a Central Bank account at the Bank of England, the commercial banks providing sterling to the figure required. Domestic inter-bank transactions and the maintenance of whatever cash ratio is considered desirable against deposit liabilities within the Republic have no relation to sterling, and could be dealt with by the commercial banks obtaining balances with the Central Bank through the sale to it of Irish securities.

These alterations, simply making entries in Dublin now made in London, will not in any way affect confidence in the currency and can be carried out at negligible cost. The surplus profit payable to the State by the Central Bank, which goes in relief of taxation, will be substantially increased and the sterling position of the commercial banks will benefit by the productive investment of funds now kept idle.

I fail to see any merit in the proposal that the Central Bank should take over all the sterling of the Commercial banks, which, amongst other difficulties, would necessitate equitable compensation by way of the rate of interest to be paid on the corresponding deposits with the Central Bank.

While Mr. Gibson considers it a "must" that the accounts of the Irish Government should be taken over by the Central Bank I am not satisfied that this is necessary or desirable. Dealing with the
banking transactions of the Government would necessitate the creation of a new and expensive department and the Central Bank would have to provide sterling to meet cheques payable outside the State, now the obligation of a commercial bank. The costs, etc. involved may not be compensated for by any benefits derived.

Mr Gibson, in reply: Before I try to reply to some of the points raised in the discussion I would like to thank the Society for the privilege of reading a paper before them. To the members present I would like to extend my thanks for a courteous hearing despite the fact that some—perhaps most—of you disagree entirely with what I have said.

It might be advisable if I stated once more in a few words the gist of the paper. Fundamentally it depends upon the acceptance of a couple of general propositions. One, that monetary policy is important. In particular, the creation or destruction of purchasing power is important, and the extent to which this takes place over any period of time can have serious consequences for a community. Two that monetary and economic policies need to be co-ordinated in the interests of economic stability. The thesis of the paper is that the co-ordination of monetary and economic policy is difficult to achieve satisfactorily under the present system. I will now turn to the comments of Mr Lynch and Mr Brock.

Fundamentally, Mr Brock does not accept the need for monetary policy from the national point of view and consequently cannot see the need for an integration of monetary and economic policy he rejects my entire position. In one sense there is little more to be said. However, there are a few points that deserve specific comment.

Mr Brock accuses me of being unable to support my statement “that the present monetary system makes co-ordination unnecessarily difficult to achieve.” I would ask him to read my section once more on the “Behaviour of the System in Recent Years.” If co-ordination had been a reality, and if the Central Bank had had sufficient power, would the net external assets of the banks have fallen as far as they did?

Mr Brock further states that “the old theory that advances create deposits was blown sky high here between 1954 and 1956—” I am not sure if Mr Brock is serious and really means that banks cannot create purchasing power. I hope he would admit that a cheque is purchasing power when it is drawn on a sound bank by a customer who happens to be in the “red” and who is within his overdraft limit. I think he recognises this because he admits that the expansion of the banks’ assets at home in 1955 and 1956 meant a more or less corresponding loss of net external assets. This, of course is the whole point and emphasises the need for a monetary policy which might conserve the net external assets in so far as it was decided that this was the thing to do. This is also the point Mr. Lynch is making when he says that, “A centralisation of control over the creation of credit might prevent the recurrence of the serious deficit which took place in 1955 in the balance of payments.”

There is a further point of Mr. Lynch’s that I would like to elaborate. He is concerned that the banks should so operate that their combined sterling reserves are adequate both in their own commercial interest
and in the national interest. There is in fact reason to believe that it is not enough from the point of view of the national interest that something should be a sound commercial transaction from the viewpoint of an individual bank. More specifically, an advance which may be perfectly sound for the individual bank may mean directly or indirectly a loss of net external assets which the national interest cannot afford. This is one paramount reason for a consciously coordinated monetary policy related to the economic position.

Mr. Collins is right to correct me for not explicitly saying that the redemption of legal tender is optional in Dublin. I shall see that this is corrected.

It seems to me that Mr. Collins’ proposals would either prevent or at best delay the Central Bank from becoming responsible for an effective monetary policy. He would let the banks retain their sterling and at the same time apparently abolish the 100 per cent external reserve principle for the note issue. Together, these in my opinion constitute a retrograde step. His statement, if I understand him aright, that “the maintenance of whatever cash ratio is considered desirable against deposit liabilities within the Republic (has) no relation to sterling” is a fallacy. Domestic monetary policy cannot be formulated independently of, amongst other things, the sterling assets of the system.

Finally, I would like to say that I realise that a managed monetary system is not easy to accomplish in the position of the Republic, and must seem very alarming to those accustomed to the old system. However, I believe that this is a real and pressing problem and that it would pay the banks themselves to recognise the problem and to search for a solution. It may be that there is some simpler way than I have been able to discover. One thing is certain, it would be a tragedy if the Republic was to slip into a severe crisis through inaction.