

# STATISTICAL AND SOCIAL INQUIRY SOCIETY OF IRELAND.

## SOME REFLECTIONS ON COMMERCIAL BANKING WITH SPECIAL REFERENCE TO THE BALANCE SHEETS OF BANKS OPERATING IN AN SAORSTAT.

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An examination into the figures of the combined balance sheets furnished quarterly by the Currency Commission discloses the financial strength of the banks operating in An Saorstát, and the liquidity of their assets. Such an examination conveys the assurance of security for the deposits of their customers. The efficiency with which this duty has been carried out is displayed by the fact that for nearly a century no Irish bank has failed to repay its deposits. Ireland has been spared the disasters that befell from time to time the banks of many countries, begotten by adventurous banking or by deviation from the course upon which commercial banking can be safely conducted, and which alone will insure the prompt payment to their deposit-holders for whom they act in the nature of trustees. As we are not conscious of good health while we possess it, and do not appreciate its value until it becomes impaired, so likewise, we are apt not to appreciate the value of good banking while it is functioning in health.

### **Function of Commercial Banking**

The function and limitations of commercial banking are misunderstood by many of its critics. Hence, it will, perhaps, facilitate the comprehension of its meaning in the balance sheets of the banks under review, if I explain briefly the general nature of commercial banking. As this part of the subject would require for its adequate treatment a paper all to itself, I shall be unable to discuss many of its other important features.

The capital and reserves of the eight shareholding banks operating in An Saorstát under the Currency Act, 1927, were for an average of the three months of the Quarter ended September, 1935, £17,265,105, while the Deposit and Current Accounts were £163,219,512. When one considers that the Loans and Advances for the same period were £68½ millions, it is obvious that the funds for these Loans and Advances were furnished by the deposits to the extent of two-fifths.

There are items in the Current, Deposits and other Accounts which should be segregated. For instance, there are savings-deposits subject to withdrawal at notice, and the Deposits or Current Accounts subject to withdrawal by cheque, which are the fund out of which day-to-day trade and personal expenditure are financed. The banks of An Saorstát do not separate these items in their published balance sheets. Savings-deposits of the banks of Great Britain and Ireland formed 48 per cent. in November, 1934, and 45.9 per cent. in November, 1935, of total deposits. I am of opinion that one would not be far wrong in stating that the savings-deposits of the banks operating in An Saorstát exceed this proportion by a considerable amount, and form approximately 70 per cent. of total deposits. This large proportion of savings-deposits has important consequences on banking policy by forcing Saorstát banks to tie up a greater percentage of their funds in long-term or gilt-edged stocks, than obtains in English banks. Further, banks with a large proportion of savings-deposits are more liable to be called upon to liquidate their investments in times of a banking or of a currency crisis,

than those whose deposits are mainly current accounts. Such forced liquidation of large blocks of securities may have far-reaching ill-effects on the value of the securities.

The average farmer, shop-keeper, and citizen of moderate means who makes small savings, does not usually invest his savings, but places them on deposit in the banks, and, to a more limited extent, in the Post Office Savings Bank. This practice obtains in Ireland to a much greater degree than in Great Britain. Hence, he regards the banks as the trustees for his savings, and, from this point of view, banks in An Saorstát partake to a greater extent of the nature of savings banks, like the Post Office and other savings-banks, than in other countries. Though these deposits are subject to notice, yet, the banks, as a result of their experience and calculation of average withdrawal of such deposits, are in a position to invest large proportions of these savings in securities, and keep smaller reserves in proportion to Assets than banks in Great Britain, where current accounts form a much greater proportion of total deposits. But, on the other hand, banks have to visualize abnormal circumstances and the possibility of withdrawal of a considerable amount of these deposits. Hence, they are compelled to retain a large proportion of their deposits in investments which can be converted readily into cash, and whose value will not suffer a substantial depreciation by such sale. The Post Office Savings Bank invests practically all its savings-deposits in liquid securities, so as to be in a position to meet at very short notice, if necessary, the abnormal demands of depositors. No criticism is brought against the Post Office for such prudent practice: it would, probably, be severely censured if it acted otherwise. Hence, reason expects, and prudence dictates, that the banks of An Saorstát which partake to a considerable extent of the nature of savings banks, should invest a large proportion of their deposits in liquid securities and not tie them up in long-term loans.

As long as commercial banks operate to a large extent on savings-deposits—a fortiori in An Saorstát—and while their capital forms a small percentage of their total funds, so long will they be compelled to invest a large proportion of such funds in liquid securities.

The loans and advances to which a proportion of their funds is devoted must likewise be of a nature, that will be repayable within a reasonable time. Hence, such loans should be essentially for the provision of working capital. Banks are precluded by their nature from financing, in any large measure, long-term loans. And if they do, they are very limited to the extent to which they can safely grant them. Demands for such loans can only be adequately met by making the capital of the banks form a much larger proportion of their resources, and by ear-marking such increased capital for long-term loans—for example, for the financing of industry. Or, the banks could form among themselves a combined company whose capital would be furnished partly by themselves and partly by the public or completely by the public. As such capital is not subject to repayment it would be available—less the necessary reserves and working expenses—for investment in industrial and agricultural undertakings. The last, and the present, government have met this demand by the creation of the Agricultural Credit Corporation and the Industrial Credit Company. Further, the banks must select securities which are readily liquid and have a wide market. The securities which meet these requirements in the highest degree are British Government Securities. They are always marketable, and though the proportion held by the banks of An Saorstát is absolutely large, yet, they form a small fraction of the total amount—not more than one per cent.

Banks in An Saorstát have no option but to retain in their portfolio only a limited quantity of Saorstát Government and Municipal Securities. The quantity of such securities available is small in proportion to the quantity of funds seeking investment and their market is narrow. For instance, the sale or purchase of these securities, even on a small scale, lowers or raises appreciably their market value. Hence, all Savings Banks, Post Office and others, and institutions holding trust funds invest the major portion of their funds in British Government securities.

There are cyclical fluctuations in the profits of banks. In fact, in recent years the calculation of banks' profits is no longer the automatic process of deducting the working expenses and payments for interest on deposits from the total receipts of interest earnings. Real profits are masked to some extent by the drawing on or taking from the Reserves.

Disclosed Reserves may arise from the placing to a special fund called Reserve Fund or Rest, (1) a portion of the earnings of good years that have accrued from the excess of interest earnings over interest paid on deposits and working expenses, (2) a portion of interest received from investments, (3) earnings realised on the sales of securities. In addition to the Reserve Fund, it appears that banks have "hidden" reserves, which are accumulated by placing some of the reserves of the above three classes—especially earnings on sales of securities—among the deposits.

Further, there are also other "hidden" reserves of a more or less *potential* character which consist of the excess of the current market value of securities above their cost price, but which have not been brought into the accounts.

It is probable that banks have in recent years been constrained to sell some of their appreciated securities in order to maintain, or approximate to, their customary rate of dividends, and thereby offset the smaller earnings from (1) decreased loans and advances, (2) from low rates of interest on Treasury Bills and Call Money (in recent years approximately 1/2 per cent per annum), and (3) frozen debts they credit their current earnings with the profits realized. It is a debatable point as to whether commercial banks should adopt this practice in a substantial measure. In so far as they do so, they are assuming the functions of investment enterprises. But it is beyond dispute that they should not credit their earnings with an appreciation of the value of the securities which they *retain*, because they are thereby discounting profits, which may not reach up to their expectations. For instance, if circumstances should arise which would compel them to sell substantial blocks of such securities—to meet increased demands for loans and advances, or other unforeseen contingencies—their value may depreciate from the figure at which they appraised them in their accounts.

Even if the administration of banks was taken over by the Government, the methods of disposing of their funds would not be different from those adopted at present—if the banks were to function as commercial banks. The distribution of their funds between liquid loans and investments in degree and kind would have to be in the existing proportions.

If banks were to make a practice of giving credit (and thereby increase their deposits) to people who capitalize their hopes, without backing these hopes by collateral of equivalent value, they would produce effects similar in kind to those produced when governments issue currency without collateral and on the general credit of the community. They would thereby lead not only to inflation (as in the case of government-created deposits) but bring about their own insolvency.

Personally, I am convinced that the banks of An Saorstát are always ready to lend to people who are credit-worthy or who have tangible security to offer. And while prudent banking precludes commercial banks from tying up a substantial proportion of their assets in long-term loans, yet, instead of criticizing them for being too rigid in this respect, it might be stated that they are lenient, as many of their loans are virtually long-term loans, and of a character not easily marketable. Business does not suffer from credit scarcity, but from disparities and maladjustments in economic relations. In fact, banks are suffering at present from the insufficiency of credit-worthy applicants for loans.

### Creation of Deposits

It is not irrelevant at this point to refer briefly to the assertion frequently made, that banks create money, create deposits and credit, and that they control purchasing power to the disadvantage of the community in general. It would go beyond the purpose of this paper to discuss this subject at length, but I suggest that it form a subject for a paper for this Society at some future time. I shall comment only briefly on one important aspect of the subject.

Banks do not create money or legal tender. Legal Tender Notes are issued by the Currency Commission as determined by law and are covered pound for pound by British Government securities.

Consolidated Bank Notes are issued by the Currency Commission to the banks, and covered by liquid assets furnished by the banks requiring them. In ultimate analysis it is the Government or Oireachtas that determines and controls the issue of such money. The banks pay a tax in proportion to the average bank note circulation equivalent to three per cent. this tax leaves them little, if any, profit thereon.

As regards the creation of deposits and credit, one must not take the word *creation* in its literal sense. Banks do not create deposits or credit out of nothing. Banks may give rise to deposits by exchanging their promise to pay for collateral—marketable values—submitted to them. They may credit the credit-worthy borrower with funds for the amount of the loan, thereby giving him a deposit. The bank simply takes the borrower's collateral, representing real identifiable value *somewhere*, which is not *generally* accepted as a means of payment for its promise to pay which is *generally* acceptable. But the bank's promise to pay on the deposits which are occasioned by the loan is based on, and represents, other values or assets which the bank holds. The bank causes to circulate, through the medium of its credit or deposit the iron goods, textiles, paper, leather, etc., in process of manufacture. It is essential to bear in mind that there is always exchange of real value for real value. Usually, the value of the loan is, as a matter of precaution against risk, less than the value of the collateral. There is no creation of deposits or of credit out of nothing.

Banks, in my opinion, might be aptly called registry offices of claims to values. Banks, Post Office and Savings Banks do not hold physical values of any kind except their premises and equipment. The Currency Notes and Consolidated Bank Notes they hold are only claims to real values that have an existence somewhere.

### Purchasing Power

As regards Purchasing Power, it consists of the exchange of commodities for commodities, or commodities for services, or services for services.

Banks simply register the value of, and facilitate the exchange of, such services and commodities. I said that the values exchanged by banks for the values submitted by their customers have—like the borrowers' collateral—a basis in some tangible identifiable value of property somewhere.

Owing to the complexity of economic organisation it would be difficult, perhaps impossible, to identify such values in tangible things, but, nevertheless the values are identifiable somewhere; otherwise, the whole fabric of credit would collapse. When the French revolutionary Government based the value of their assignats on the abstract value of land in general and other un-identifiable marketable units of government property, the value of the assignats in due time became almost worthless— $1/1,700$  of their parity value. Barbers papered their shops with the United States Continental notes—hence, the byword, “not worth a continental.” When the German Government during, and immediately after, the close of the War issued currency in almost unlimited quantity without collateral and tangible values, the mark fell to nothing. The British Government in order to finance its war needs borrowed on a considerable scale by means of Treasury Bills and Ways and Means. This borrowing resulted in increased bank deposits, which compelled the Government to issue currency notes in large quantities to enable the banks to maintain their customary ratio of cash to deposits. Such borrowing, without collateral, affected all values adversely. Governments are said by this means to create Purchasing Power, but by so doing they only raise prices and thereby eventually bring about such a dislocation in the equitable price relations, that the whole economic system is put out of gear. Hence, the legacy of depression which the Great War has bequeathed to the world and from the consequences of which we are endeavouring even still to extricate ourselves. Therefore, in so far as banks increased their deposits during and after the War, the source of those increases was the Government. Governments alone can, in countries such as Great Britain and Ireland whose banking organisation is concentrated in large units, give rise to deposits to a significant extent other than those created by the ordinary growth of trade and commerce. Banking amalgamations did, to some extent enable banks to increase their deposits by effecting economies in the proportion of their reserves to liabilities.

Money in the ordinary sense is not a source of purchasing power, but a medium for facilitating exchange. Such instruments of business as money, bank cheques or deposits, promissory notes, stocks, shares are simply evidences of claims of ownership and are incorrectly spoken of as wealth. Purchasing power originates in the production and exchange of goods and services between the various industries and occupations. Goods and services of different kinds pay for one another and create demand for one another. Purchasing power arises from no other source but out of these exchanges. Prosperity consists in balanced relations of value for value in exchanges of different kinds.

#### **Combined Balance Sheets of Eight Shareholding banks, and National City Bank**

The figures in the table hereunder represent an analysis of the figures of the balance sheets of the eight shareholding banks under the Currency Act, 1927, and the National City Bank, Limited. The Ulster Bank and the Northern Bank, which operate throughout An Saorstát and are incorporated in Northern Ireland, are included in these figures.

BANKING RETURNS MARCH, 1932—SEPTEMBER, 1935

(These figures are taken from the Quarterly Statistical Bulletin of the Currency Commission and cover all the eight shareholding banks under the Currency Act, 1927, and the National City Bank, Ltd.)

(£000's omitted)

|                                   | First<br>Quarter<br>1932 | Second<br>Quarter<br>1932 | Third<br>Quarter<br>1932 | Fourth<br>Quarter<br>1932 | First<br>Quarter<br>1933 | Second<br>Quarter<br>1933 | Fourth<br>Quarter<br>1933 | Second<br>Quarter<br>1934 | Fourth<br>Quarter<br>1934 | Second<br>Quarter<br>1935 | Third<br>Quarter<br>1935 |
|-----------------------------------|--------------------------|---------------------------|--------------------------|---------------------------|--------------------------|---------------------------|---------------------------|---------------------------|---------------------------|---------------------------|--------------------------|
| <b>LIABILITIES</b>                |                          |                           |                          |                           |                          |                           |                           |                           |                           |                           |                          |
| Capital and Reserves              | £                        | £                         | £                        | £                         | £                        | £                         | £                         | £                         | £                         | £                         | £                        |
| In Irish Free State               | 13,080                   | 13,120                    | 13,118                   | 13,003                    | 13,085                   | 13,089                    | 13,133                    | 13,165                    | 13,110                    | 13,241                    | 13,339                   |
| Elsewhere                         | 3,734                    | 3,745                     | 3,773                    | 3,781                     | 3,798                    | 3,806                     | 3,805                     | 3,850                     | 3,883                     | 3,902                     | 3,926                    |
| Notes                             |                          |                           |                          |                           |                          |                           |                           |                           |                           |                           |                          |
| In Irish Free State               | 5,112                    | 5,064                     | 5,066                    | 5,137                     | 5,136                    | 5,153                     | 5,086                     | 5,146                     | 5,101                     | 5,126                     | 5,165                    |
| Elsewhere                         | 2,946                    | 2,989                     | 2,895                    | 2,930                     | 2,965                    | 3,117                     | 3,104                     | 3,218                     | 3,295                     | 3,435                     | 3,349                    |
| Deposits                          |                          |                           |                          |                           |                          |                           |                           |                           |                           |                           |                          |
| In Irish Free State               | 124,228                  | 127,700                   | 129,616                  | 131,573                   | 134,486                  | 129,027                   | 123,806                   | 123,386                   | 119,814                   | 118,135                   | 116,757                  |
| Elsewhere                         | 39,167                   | 40,273                    | 43,251                   | 45,376                    | 46,650                   | 46,895                    | 46,131                    | 45,085                    | 45,096                    | 46,500                    | 46,463                   |
| Total Liabilities                 |                          |                           |                          |                           |                          |                           |                           |                           |                           |                           |                          |
| In Irish Free State               | 145,430                  | 149,295                   | 151,029                  | 152,966                   | 156,036                  | 151,298                   | 145,681                   | 144,898                   | 141,648                   | 139,531                   | 137,921                  |
| Elsewhere                         | 47,875                   | 49,297                    | 51,701                   | 53,973                    | 54,908                   | 55,460                    | 54,790                    | 54,097                    | 54,352                    | 56,305                    | 55,597                   |
| <b>ASSETS</b>                     |                          |                           |                          |                           |                          |                           |                           |                           |                           |                           |                          |
| Cash and Balances with<br>Banks : |                          |                           |                          |                           |                          |                           |                           |                           |                           |                           |                          |
| In Irish Free State               | 4,409                    | 5,706                     | 4,518                    | 4,862                     | 4,862                    | 4,631                     | 5,041                     | 4,882                     | 5,012                     | 4,849                     | 4,348                    |
| Elsewhere                         | 8,179                    | 8,164                     | 10,137                   | 10,608                    | 10,607                   | 10,005                    | 10,492                    | 7,901                     | 8,806                     | 9,554                     | 9,126                    |
| Money at Call and Short<br>Notice |                          |                           |                          |                           |                          |                           |                           |                           |                           |                           |                          |
| In Irish Free State               | 4                        | 4                         | 3                        | 2                         | 3                        | 2                         | 3                         | 2                         | 5                         | 3                         | 3                        |
| Elsewhere                         | 10,388                   | 10,220                    | 10,472                   | 12,914                    | 14,745                   | 12,010                    | 9,133                     | 10,662                    | 10,517                    | 9,133                     | 10,239                   |

|  |         |         |         |         |         |         |         |         |         |         |         |
|--|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
| Bills  |         |         |         |         |         |         |         |         |         |         |         |
| In Irish Free State                                    |         |         |         |         |         |         |         |         |         |         |         |
| (a) Government   | 1,000   | 1,000   | 1,000   | 1,416   | 1,917   | --      | --      | --      | --      | --      | --      |
| (b) Other  | 6,070   | 6,139   | 6,142   | 5,987   | 5,930   | 5,899   | 5,690   | 5,647   | 5,452   | 5,403   | 5,338   |
| Elsewhere  |         |         |         |         |         |         |         |         |         |         |         |
| (a) Government   | 3,233   | 2,667   | 2,421   | 2,842   | 2,292   | 851     | 826     | 19      | 120     | 42      | 83      |
| (b) Other  | 2,210   | 1,836   | 1,607   | 1,632   | 1,635   | 1,683   | 1,628   | 1,640   | 1,558   | 1,459   | 1,196   |
| Loans and Advances                                     |         |         |         |         |         |         |         |         |         |         |         |
| In Irish Free State                                    | 44,918  | 45,388  | 44,923  | 43,900  | 43,899  | 42,796  | 42,702  | 44,028  | 44,741  | 44,438  | 44,469  |
| Elsewhere  | 27,856  | 27,734  | 27,200  | 26,314  | 26,314  | 25,487  | 24,963  | 25,242  | 24,532  | 23,888  | 23,827  |
| Investments  |         |         |         |         |         |         |         |         |         |         |         |
| In Irish Free State                                    |         |         |         |         |         |         |         |         |         |         |         |
| (a) Government   | 2,075   | 2,174   | 2,174   | 2,365   | 2,319   | 2,397   | 2,663   | 4,595   | 4,321   | 4,045   | 3,946   |
| (b) Other  | 1,572   | 2,808   | 2,709   | 2,930   | 2,903   | 2,827   | 2,910   | 3,321   | 3,117   | 3,246   | 3,425   |
| Elsewhere  |         |         |         |         |         |         |         |         |         |         |         |
| (a) Government   | 70,133  | 77,251  | 77,251  | 78,298  | 82,767  | 82,800  | 79,201  | 78,636  | 73,778  | 74,540  | 73,905  |
| (b) Other  | 3,604   | 4,672   | 4,672   | 5,058   | 5,313   | 5,650   | 5,887   | 5,829   | 5,937   | 5,787   | 5,882   |
| Total Assets   |         |         |         |         |         |         |         |         |         |         |         |
| In Irish Free State                                    | 63,250  | 65,721  | 64,539  | 64,691  | 64,178  | 62,984  | 62,698  | 65,853  | 66,193  | 65,369  | 64,770  |
| Elsewhere  | 130,055 | 132,871 | 138,192 | 142,247 | 146,766 | 143,775 | 137,773 | 133,142 | 129,807 | 130,467 | 128,749 |
| Excess of External Assets<br>over External Liabilities | 82,180  | 83,574  | 86,490  | 88,274  | 91,858  | 88,315  | 82,983  | 79,044  | 75,455  | 74,161  | 73,152  |

Excess of External Assets over External Liabilities in 1st Quarter, 1932      £82,180,000  
 " " " " " " " " " " 3rd " 1935      £73,152,000

NOTE—Decrease of      £9,028,000  
 Deposit and Current Accounts 31st December, 1931.  
 Within Irish Free State      £121,999,868  
 Outside Irish Free State (Elsewhere)      £40,849,014

"Elsewhere" means the location in Northern Ireland and Great Britain of the sums to which reference is made. For instance, while the Ulster Bank and the Northern Bank operate both in Northern Ireland and in An Saorstát, the banks incorporated in An Saorstát also operate in Northern Ireland with the exception of the Royal Bank. Hence, the financial transactions of both groups of banks in Northern Ireland are classified in these returns as "Elsewhere." Further, the National Bank, whose Head Office is in London, has 24 branches in Great Britain its financial transactions at these branches are classified in these returns as "Elsewhere." The Provincial Bank has also its Head Office in London but carries on no ordinary banking operations in Great Britain. The Royal Bank has one branch in Great Britain. It is important to keep in mind these spheres of operations in interpreting the Current Deposit and other Accounts as well as Loans and Advances.

### **External Sterling Holdings**

It is a matter of interest to contrast the Assets "Elsewhere", with the Current and Deposit Accounts "Elsewhere." The difference represents the net sterling assets attributable to An Saorstát, which in the September quarter, 1935, were £73,151,492. It will be observed that in the first quarter of 1932 the net sterling assets were £82,180,000, and that they increased to £91,858,000 in the first quarter of 1933, and from thereon decreased to £73,151,492 in the third quarter of 1935—a decrease of £9 millions as compared with the first quarter of 1932, and of £18½ millions as compared with the first quarter of 1933. This decrease has been commented upon as a feature of the economic trend of the country, that gives ground for apprehension, or at least for watchfulness.

An examination of some of the causes that may have been responsible for the decrease, may help to remove anxiety on this aspect of the economic life of An Saorstát.

The period 1932-35 may be regarded as abnormal for the following reasons —

- (a) The retention since June, 1932, in suspense accounts of the Land Annuities and other payments claimed by the British, namely, £4,820,000, until the second quarter of 1933 (when they were disposed of for the benefit of the Exchequer) increased the Exchequer balance in the banks which, when invested in British and other securities, increased the sterling assets "Elsewhere," without increasing the liabilities "Elsewhere." As they were subsequently used to meet Government expenditure (from the second quarter of 1933 onwards) their sale decreased these assets. The Government expenditure would be spent for the most part in the purchase of consumption goods, and, to some extent on the imports of such goods.

In so far as any of the proceeds of this expenditure reverted to the banks, it would do so, probably, in the form of current accounts, thereby preventing the banks from investing as large a percentage, if any, of such deposits in gilt-edge securities as they would in the case of deposits-savings.

- (b) During the banking crisis in the United States, 1932-33.



it is estimated that approximately £4 millions sought refuge in banks in An Saorstát and were probably repatriated from 1933 onwards. The import of such funds increased the banks' sterling assets, while their subsequent repatriation decreased them

- (c) The conversion of British War Loans towards the end of 1932, induced, probably, some Saorstát holders thereof to take cash for their holdings, which would increase the assets of the banks of An Saorstát and their investment "Elsewhere." In so far as the owners of these assets re-invested them subsequently in British Government or British Industrial Securities the assets of the banks would be correspondingly reduced. The consilience of these various causes accounts, to a large extent, for the increase and the decrease of the net sterling assets throughout the period.

But now that the operation of these causes has probably spent itself the net sterling assets for the third quarter of 1935 should be approximately the same in amount as those for the first quarter of 1932, if no other causes were at work. Yet, they were £9 millions less. It has been suggested that a sufficient explanation of the decrease in net sterling assets is the repatriation of funds for the financing of new industries in An Saorstát. An analysis of the value of the import of durable or capital goods (raw materials, machinery, articles manufactured and unmanufactured that enter into the construction of capital goods), indicates a maximum increase approximately of £1 million sterling for 1934 over that for 1931, £2½ millions for 1932 and £2 millions for 1933—that is an increase for the whole period of *not more than* £5¼ millions and probably less.

It has been alleged that withdrawals by farmers of their deposits to meet current expenditure were of sufficient magnitude to decrease appreciably investments "Elsewhere" of the banks. Figures are not available to the public to measure this decrease of farmers' deposits though the banks are in a position to ascertain whether or not such withdrawals were considerable.

Further, it is possible that some deposits may have been withdrawn from the banks and transferred to the Post Office Savings Bank to take advantage of the better rate of interest paid by the latter. In fact, the balance due to depositors in the Post Office Savings Bank (including interest) increased from £4,172,000 at 31st December, 1932, to £5,586,000 at 31st December, 1934—an increase of £1,414,000. But it is equally possible that some of those who until June, 1933, used purchase Saving Certificates invested their savings in the Post Office Savings Bank, as the rate of interest at which Saving Certificates were issued after July, 1923, was reduced, thereby making the long-run yield on the former greater than on the latter.

It might also be alleged that holders of deposits, may to some extent have withdrawn them, and invested them in British industrial securities, the values of which have recently been appreciating.

Hence, the operation of the above three causes suggests an adequate explanation of the decrease in net sterling assets of the third quarter of 1935, as compared with the peak quarter of 1933.

But a closer analysis suggests additional grounds of explanation. There has been a decrease in the deposits and current accounts within An Saorstát from £122 millions at December 31st, 1931, to £116¼ millions in the third quarter of 1935, while there was an increase during the same

period in deposits and current accounts "Elsewhere," from £400 millions to £46½ millions. These deposits attained the figure of £46,895,000 in the first quarter 1933 which was the peak quarter of total deposits, thereafter they declined to £45 millions in the second and fourth quarters of 1934 and to £44½ millions in the third quarter, but they reverted to £46½ millions in the first, second and third quarters of 1935. Throughout the period 1932-34, the total deposits of the Belfast Banking Company decreased by £216 150

#### Shifting of Deposits "Elsewhere"

The conclusion suggests the hypothesis that there was a shifting of the domicile of some of the deposits from the banks operating in An Saorstát to their branches "Elsewhere." This shifting—on the above assumption—does not change the ownership but only the domicile of the deposits. Nevertheless, their classification as deposits "Elsewhere" transfers them from the category of Saorstát assets to Saorstát liabilities, decreasing "pro tanto" the net external assets.

In so far as deposits held in An Saorstát were invested in Saorstát industries, they would result in a change from deposits to current accounts, and would have the effect of the reducing the investments of the banks to approximately the amount of such transference. But the figures we have analysed do not suggest an adequate transference of this character. It is to be hoped that Saorstát banks will follow the example of some of the British banks, and separate the value of their time deposits from current and other accounts.

Hence, it would appear that the financing of our new industries, and the development of existing industries during the years 1933 and especially 1934 and 1935 (six months), has not been substantially incurred at the expense of the investments "Elsewhere" of the banks or of their net sterling assets.

Yet, a substantial amount of new capital has been invested in the period 1933/35 in new industries and in the development of existing industries, as also in new capital issues on Government and Municipal account.

The following Public Issues have been made 1932-1935 —

|  |             |
|--|-------------|
| 1 Government Funds and Trustee Stocks  | £10,003,500 |
| 2 Other Issues of Debentures and Stock                                       | 263,200     |
| 3 Issues of Share Capital  | 3,964,841   |
| 4 Guarantees by Minister for Industry and Commerce<br>under Trade Loans Acts | 500,000     |
|  | £14,731,541 |

Some of this capital was contributed by non-nationals, but not more than 15 per cent. of the total amount.

Further, there was investment of capital of an unascertainable amount in private firms which did not make public issues.

If the financing of those various issues was not provided, to a substantial extent at the expense of the net sterling assets, they were probably financed wholly or in part from assets held by private individuals "Elsewhere," and out of current savings.

While figures are publicly available for showing the trend of the net sterling assets of the banks over the period under review, no figures are available for comparing the sterling assets held "Elsewhere" by

individuals and companies (other than banks) Hence, we are not in a position to know to what extent those assets have been reduced by their repatriation for home investments

The following table gives an indication of the total assets "Elsewhere," of persons resident in An Saorstát, or of companies or of firms with headquarters situated therein —

ESTIMATE OF THE INVESTMENTS OF IRISH FREE STATE IN GREAT BRITAIN AND NORTHERN IRELAND, DECEMBER, 1934

|   |   |                     |
|---|---|---------------------|
| 1 | Estimate of investments of Banks in British Government Securities and in those of Government of Northern Ireland (exclusive of Ulster Bank and Northern Bank)   | £59,022 000         |
| 2 | Investments by Irish Free State Government in British Government Securities as Cover for Legal Tender Currency, Post Office Savings Unexpired Sinking Fund or National Loan, Trustee Savings Banks                              | 15,546.681          |
| 3 | Estimate of holdings of private individuals and companies (other than banks) in British Government and Indian Securities  | 55,000 000          |
| 4 | Estimate of other investments and assets of the banks of Irish Free State in Great Britain and Northern Ireland (exclusive of Ulster Bank and Northern Bank and of the cash balances of Saorstát Banks in branches "Elsewhere") | 43,250,000          |
| 5 | Estimate of other investments and assets of individuals and companies (other than banks) in Great Britain and Northern Ireland  | 55,000,000          |
|   | Total investments and assets  | <u>£227,818,681</u> |

The reason why the external assets of the Irish Free State are in proportion to the population, of such large dimensions is that no outlet was available in An Saorstát for the savings which have been considerable since 1906, and which increased far out of proportion to its economic development Hence, it is obvious from the figures mentioned that such repatriation of funds as took place forms but a small proportion of our total foreign assets

#### Loans and Advances :

Space does not permit a close examination of some other figures in the Table, but reference to the Loans and Advances shows that these in An Saorstát are approximately the same in 1935 as in the first quarter, 1932 They decreased by £2½ millions in the second quarter of 1933, but they reverted to within £½ million of those of the first quarter of 1932 Probably, the decrease in Loans and Advances to farmers and cattle dealers as a result of the economic dispute was offset by increase in Loans and Advances to industry The Loans and Advances which

appear in the Consolidated Balance Sheet, form 43.3 per cent of the total deposits, why this proportion is not more, is due to the facts already mentioned; and why it is somewhat less than obtains in the British Shareholding Banks is due to the reason that a very much larger percentage of the deposits of Saorstát banks is attributable to the deposit of savings which do not go to British banks, and to the larger field for the supply of working capital and commercial bills which exist in Great Britain. Investments in Saorstát Government securities increased in the period from £2,075,000 to £3,946,000, while other investments (Municipal, etc) increased from £1½ millions to £3½ millions. The Treasury Bills, £1 million during quarter 1932, and £1.9 million in first 1933, were paid off by the Government. Investments "Elsewhere" (mainly British Government securities) increased from £73¾ millions to £79¾ millions. Hence, An Saorstát is a creditor nation with considerable liquid external assets, and holds fifth place among the comparatively few creditor nations of the world. While per head of the population those assets are approximately equal to those of Great Britain.

Perhaps, in administrative details, banking in An Saorstát might be more economically organised, but, whether the general interests of depositors and the community would thereby be better served remains to be proved. The forthcoming findings of the Banking Commission will probably furnish facts on which a valid opinion can be formed. It will, probably, ascertain whether the general economic interests of the country are efficiently served by the existing banking organisation, and, if not, it will probably indicate what changes should be made in its structure and administration to meet any needs which are not at present adequately served.

#### Decrease of Net Sterling Holdings may be a Gain

Before judging whether a decrease or increase of such sterling holdings is a financial loss or gain, one must analyse and evaluate the various factors which give rise to changes in their value. Such evaluation and analysis present many difficulties. In so far as a decrease results from their transfer to investment in Saorstát undertakings, which would increase in the long-run its wealth, such a reduction would be a national gain. The reason why An Saorstát is a creditor country is due to the fact that in the past there was no outlet commensurate with the amount of savings its citizens had accumulated. Therefore, one would expect that an industrial development should lead to a demand for its savings and to a decrease in its external sterling holdings, or, at all events, a tendency to have the rate of investments abroad decrease if the national savings are only on a scale commensurate with such a development. In fact, it is conceivable that the full amount of sterling holdings of An Saorstát would be repatriated for its economic development over a period of time, on the supposition that this development and the increase of its population were of a magnitude capable of absorbing such funds and that the belief of their owners existed for its profitable investment both as regards their security and yield. In this event *visible* exports should equal in value *visible* imports, or an excess of *visible* imports should be balanced by loans raised abroad—a position which would be the reverse of that which obtained in 1934, when the value of our *invisible* exports was in excess of that of our *visible* exports, and was 54.4 per cent in excess of the value of our retained imports. But such a possibility is not within sight.

In order that An Saorstát may be able to avail itself of these sterling assets for the economic development that is feasible, certain fundamental conditions must be fulfilled

In the first place taxation must not be excessive. Excessive taxation tends to change the distribution of wealth and to increase the demand for consumption goods, it may increase such a demand at the expense of saving. Hence, care must be taken not to tax to the extent that the savings necessary for economic development (capital goods and industrial replacements) are seriously impaired. Very often the taxable capacity of a community is underrated. In practice, it is difficult to assign an economic limit to the burden of taxation which a community can economically bear, as taxation is often imposed for reasons other than economic. On the other hand, taxation is sometimes imposed for economic ends which, while obviously beneficial in a short-run period and in a narrow field, may have long-run effects adverse to the general interests of the community. Because these adverse effects are diffused over a large area and operate in small increments over an extensive range of commodities and services the original cause of their operation is obscured.

Secondly, the budget should be drawn up and balanced on orthodox lines, and expenditure for economic needs should be defrayed out of taxation. Borrowing, as far as possible, should be made only for productive expenditure, and if it is resorted to for emergency purposes, every effort should be made to remove or mitigate the cause of such emergency, and to restrain such expenditure from assuming undue proportions.

Even for social purposes, prudence dictates that the expenditure necessary to defray it should as far as possible be met out of current revenue, because having recourse to loans easy may lead too readily to the incurring of expenditure, which may be in excess of the capacity of the State to bear, and may have, in other respects, repercussions unfavourable to prosperity, and ultimately defeat its own end. The question is really a choice between a great sacrifice at once and a small one indefinitely prolonged, with unfavourable results on the rate of interest. It is a wise maxim to make present resources suffice for present wants the future will have its own wants to provide for.

The conclusion that one seems justified in drawing from the facts and arguments set forth in this paper, is that the new orientation of economic structure of An Saorstát has, so far, made no substantial encroachment on its liquid assets.

## DISCUSSION.

**Mr. Bulmer Hobson** said it gave him much pleasure to propose a vote of thanks to Professor Smiddy for his interesting analysis of the Irish banking system. He did not think it was necessary to defend commercial banks as commercial banks. They were very good banks indeed. If one had money to deposit they would keep it safely, if one were in need, the banks were both courteous and obliging. They might, however, give more information in their Balance Sheets, and they might invest a great deal more of their funds at home. Professor Smiddy said the banks had no option but to invest only a comparatively limited portion of their funds in Saorstát securities, but it was doubtful if the securities they did retain need be so limited in character as they were. Was there any other banking system that had lent to the Government of another country fifteen times as much as it had lent to its own? It was surely humiliating to read of the success of the Dublin Corporation in securing a loan of a quarter of a million from an English Insurance Company when the Irish banks had such vast funds invested abroad.

There were more than 140,000 of our fellow-citizens registered as unemployed. They wanted to exchange their services for goods. There were plenty of goods and there would be plenty more if there were a demand for them. If their services were used, they would be customers for farmers and manufacturers. Professor Smiddy had said that purchasing power had no other source than in the production and exchange of goods and services between various industries and occupations. If our financial system would not permit the use of the resources in men and material at the present time, some system that would do so should be sought for.

**Mr. Charles Eason** said that the paper was an interesting and valuable one, and he sympathised with it more than Mr. Hobson, who had digressed into the question of unemployment. This was the greatest problem of the age, and it was right that people should be concerned about it, but it was off the lines of the paper. He was glad to note that Professor Smiddy's views of correct banking procedure were orthodox, and that he was able to give the Saorstát a good character for sound finance. He was in agreement with the statement that banking advances created deposits, but not that banks only made advances when collateral was produced. It had been stated by an orthodox economist of a long time ago that a good deal of the prosperity of Scotland had been due to the willingness of the banks to advance money to young business men who wanted capital but had no collateral to produce. They had used the money well, repaid the loans, and expanded the trade of the country.

Professor Smiddy had stated that there had been no failure of an

Irish bank for a hundred years. There was, however, the case of the partial failure of the Munster and Leinster Bank, which had only succeeded in paying its depositors by calling on its shareholders.

Mr. Hobson had said that there was no money for development at home. He thought there was plenty of such money provided such development could show a prospect of making a reasonable exchange for the goods and services of those employed. He personally thought the banking community would be able to help in solving the problem of unemployment.

**Professor O'Brien** said he found little to criticise in this illuminating paper. Professor Smiddy had said that in so far as a decrease in the external sterling holdings resulted from their transfer to Saorstát investments, it would be a national gain. If an investor getting  $3\frac{1}{2}$  per cent. on his money invested outside the country removed his capital to an internal investment offering 4 per cent. backed by a Government guarantee, the transaction did, of course, represent a gain to the individual. But if the increased yield were gained by means of a tariff or some other process that raised prices to the consumer, or by a subsidy, which meant increased taxation, or if it involved—as in the case of the Sugar Company—a reduction in Customs revenue, then the private individual had increased his income at the expense of his fellow-countrymen, and it was difficult to see how the national dividend had been increased, or that the result was anything but a redistribution of the national dividend. And this had taken place at the expense of a decrease in external investments—one of the strong points of the country's economy. The experience of recent years had indicated that external investments were the greatest asset the country possessed. Without them, the standard of living in the country could not have been maintained; nor the economic war waged with the measure of success that had attended it. The maintenance of whatever currency position we wished to hold—that was to say our freedom in respect of our international exchange position—seemed to depend on the maintenance of our position as a creditor country.

Mr. Hobson hoped the banks would finance the Dublin Corporation in their future dealings. He wished the banks to buy securities the public would not buy. Unfortunately, the banks, as trustees of public deposits, had to put their money into holdings that the public would buy readily if the banks found it necessary to liquidate their resources. Otherwise they might drift into a very undesirable situation, such as had arisen in the United States where a disproportionate part of the public liability was held in the portfolios of the banks.

He was not sure that he agreed with the suggestion that the banks should draw a distinction between time deposits and current accounts. It might create some misapprehension in the public mind as to the sensitiveness of banks.

**Dr. J. F. Burke** said that Professor Smiddy had done good service in stressing the sound basis of commercial banking in Ireland, and the fact that the economic policy of the present Government had not interfered with the stability of Irish banks. He did not agree with Professor O'Brien that the withdrawal of any of our external assets for the purpose of giving employment in this country was a doubtful gain. Any measure that would enable the country to pay people for

doing work, instead of demoralising them by the dole, would be a decided gain. Professor Smiddy had not defended the large proportion of our holdings abroad—he had merely stated the fact and given reasons for it. He (the speaker) believed those reasons were disappearing, and he would be in favour of taxing all dividends coming from abroad so long as money could not be found for industry at home. Any measure taken to bring this money home from abroad was not merely justifiable but necessary.

**Mr. Hill Tulloch** said that reference had been made to the hidden reserves in the resources of the banks, and it had been stated that these reserves masked the real profits, owing to their being drawn upon, or added to. It would be more correct to say that profits were sometimes masked by the banks putting more money aside in good years than in lean years. Practically every trading company had hidden reserves in the form of provision made for doubtful debts. Another example was the provision made for possible depreciation of investments to bring them to their realisable value. A company might, however, sell investments, and instead of taking that profit into its profit and loss account, might put it to a reserve to meet possible losses in trading. If this were carried too far, and there was an investment reserve not likely to be required, then there was something in the nature of a hidden reserve, and if it rose beyond proper proportions it ought to be disclosed. A bank was in a somewhat different position. It traded on money lent to it, and must secure the people who lent the money by making provision against possible loss on advances or investments. Further, if a bank made a large loss in one year it would probably result in a run on it unless it had substantial inner reserves to meet such an emergency.

With regard to a distinction between money on deposit and money in current accounts; so far as the bank was concerned they were equal and must be provided for equally.

**Mr. Steer Wood** remarked that he had hoped that the lecturer would lift the veil that lay over the banking system, but more would have to be said than had been said to convince him that banks were not controlled by some outside powers. He had no doubt that the Bank of England exercised control over the banks in Ireland, and lately a statement had been made that the Bank of England was controlled by outside powers.

With regard to the question of banks creating credit, they were in actual fact merely shops for the issuing of credit. He had seen a statement that of two hundred millions held in cash by banks, and on the strength of which they had lent two billion pounds, only fourteen millions had come to them from ordinary deposits. Yet, 19 out of 20 persons would say that loans from the bank came out of deposits paid in by their clients. It was not deposits that created deposits—but loans. Professor Smiddy had said that the creation of credit by the Government would immediately result in inflation. As a matter of fact there was camouflaged inflation going on every day.

**Mr. J. C. M. Eason** conveyed the thanks of the Society to the lecturer for his paper. He thought there was some danger of lumping together a number of businesses known under one name as banks, averaging up their figures and drawing deductions from them, without



taking into account the fact that there were probably substantial differences in the character of each of these businesses, and the views they took as to the ratios and proper amount of advances.

A fact that had struck him was the banks were not paid for acting in the capacity in which they were most used—for the work of clearing cheques and accepting payments. In recent years there had been a charge of half a guinea, but this could not possibly meet the expenses of work for large firms constantly using the banks.

**Professor Smiddy** replied.

#### CORRIGENDA.

Page 61, 12th last line: *For* " 1923 " *read* " 1933 ".

Page 64, 4th line: *Delete* " Shareholding ".