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EIGHT EUROPEAN CENTRAL BANKS

EIGHT EUROPEAN CENTRAL BANKS

Organization and Activities
of

BANQUE NATIONALE DE BELGIQUE
DEUTSCHE BUNDESBANK
BANK OF ENGLAND
BANQUE DE FRANCE
BANCA D'ITALIA
NEDERLANDSCHE BANK
SCHWEIZERISCHE NATIONALBANK
SVERIGES RIKSBANK

A Descriptive Study

PUBLISHED UNDER THE AUSPICES OF THE
BANK FOR INTERNATIONAL SETTLEMENTS, BASLE

London
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FOREWORD

This volume aims to provide an account of the character and *modus operandi* of the central banks represented on the Board of the Bank for International Settlements.

In the existing literature on the subject more attention has been paid to the nature of central banking in general than to the particular characteristics of individual central banks. The Bank for International Settlements therefore felt that a factual account of some of the more important of these institutions would be useful, not least at a time when co-operation between central banks is of growing importance in international monetary affairs.

The eight chapters that follow have been written by highly qualified experts from the central banks concerned. The approach is broadly institutional rather than legal or historical and the chapters have been written to a common pattern in order to facilitate comparison. Each one begins with a short section on the origins of the bank concerned and the principal laws that at present apply to it. The functions and objectives of the bank are then briefly reviewed and this is followed by a description of how the bank is organized. The various powers exercised by the bank, together with the fields of its activity, are then enumerated and a final section is devoted to monetary policy. To each chapter there is attached an annex containing a specimen return of the bank as well as a note explaining, where necessary, the various items of assets and liabilities. In general, the book does not cover events occurring after the end of 1962. The returns contained in the annexes to the chapters are those for the end of that year.

The initiative for the preparation of the volume came from the Bank for International Settlements, which also acted as editor. The authors of the chapters on their respective central banks are as follows:

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Mr Sven Lindh, Sveriges Riksbank.

The Bank for International Settlements would like to express its warm thanks to the various authors and to record its particular appreciation of the valuable help given by Dr de Jong in co-ordinating the different chapters of the book.

The book is also being published in French, German and Italian.

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BANQUE NATIONALE DE BELGIQUE

I

ORIGINS AND LEGAL FRAMEWORK

The National Bank of Belgium was founded in 1850. In addition to its Head Office in Brussels, it has branches in Antwerp and Liège and in Luxemburg, the capital of the Grand Duchy which has since 1921 formed an economic union with Belgium. The Bank has opened a total of forty agencies in the main towns of Belgium.

The National Bank's legal status and activities are governed by the royal decree of August 24, 1939, adopted in execution of the law of May 1, 1939, and amended by the decree-laws of May 1, 1944 (No. 5), and September 5, 1944, and by the laws of July 28, 1948, April 12, 1957, and June 19, 1959. The Bank's charter was due to expire on December 31, 1961, but by the law of June 19, 1959, it was prolonged until December 31, 1988.[1]

The National Bank is a joint-stock company, established by a deed of partnership in accordance with the requirements of the Commercial Code. It is subject to the co-ordinated laws applicable to commercial companies, with the exception of Article 76 of the Code, which concerns shareholders' voting rights.[2] Its statutes are drawn up in accordance with the provisions of its organic law and are submitted to the King for approval.[3]

The capital of the Bank amounts to 400 million francs, divided into 400,000 shares, of which 200,000, registered and non-transferable, have since 1948 been held by the state.[4] The annual profits are distributed as follows:

(1) to the shareholders, a first dividend of 6 per cent;

[1] The texts of the various decrees and laws enumerated in this paragraph are to be found in the *Moniteur* of August 26, 1939, May 6, 1939, September 5, 1944, September 21, 1944, July 29, 1948, April 18, 1957, and June 20, 1959, respectively.

[2] Organic law, Article 5, paragraph 3; Statutes, Article 82. The question of shareholders' voting rights will be taken up again later. The organic law dates back to May 5, 1850, but various amendments have been made to it since then. The present text is that of the royal decree of August 24, 1939, as amended by the laws and decree-laws referred to in the second paragraph on this page.

[3] Organic law, Article 35, paragraphs 1 and 2.

[4] *Ibid.*, Article 5, paragraphs 1 and 2; Statutes, Article 6.

(2) of the remainder:
  (*a*) 10 per cent to the reserve fund;
  (*b*) 8 per cent to, or for the benefit of, the staff;

(3) of the surplus:
  (*a*) to the state, one-fifth;
  (*b*) to the shareholders, a second dividend fixed by the Council of Regency;
  (*c*) the balance to the reserve fund.[1]

In addition, any profit resulting for the Bank from the margin between the interest rate of 3 per cent and the actual rate charged by it on its discounts, advances and loans is assigned to the state.[2]

It might be thought that the state has a predominant influence on the Bank's activities since it virtually has an absolute majority in the General Meeting of shareholders. In fact, however, the powers of the General Meeting are now considerably limited by the clauses relating to appointments and by the provision under which the Board of Censors alone can approve the balance sheet and the General Council alone can decide on the distribution of the profits. The General Meeting's main prerogative is that of amending the statutes, which it can do by a twofold majority, viz. a majority of votes cast and of shareholders present. As the state constitutes only a single shareholder, this twofold majority requirement very radically reduces, to the point in practice of eliminating entirely, the possibility of the state's using its overwhelming majority interest to amend the Bank's statutes in such a way as to tilt in its favour the balance of power which clearly characterizes the system created by the organic law and the 1948 law.

Apart from its position as a shareholder, the government has certain powers in connection with the administration of the Bank and the appointment of its directors and regents (*régents*), a topic which will be dealt with in subsequent paragraphs. The present system, characterized as it is by a division of powers, was deliberately created by the legislature with the intention of ensuring that some control over monetary policy remained in the hands of the government without, however, giving it sole competence in this sphere. Consequently, where monetary matters are concerned, power is divided between the government and the Bank. The Bank is not a semi-public institution subordinated, for administrative purposes, to a minister. It is *sui generis*, an autonomous and private institution, but its activities are supervised by the government.

[1] Organic law, Article 21; Statutes, Article 38.
[2] Organic law, Article 20, paragraph 1; Statutes, Article 37, paragraph 1.

II

FUNCTIONS AND OBJECTIVES

The Bank's objectives are not clearly defined by the organic law, as is the case, for example, in Germany and the Netherlands.

The object for which the Bank was originally established, as set out in the statutes in application of the organic law and made clear in the course of parliamentary debates, was to carry out normal banking operations. The only essential difference between the National Bank and other private banks lay in the note-issuing privilege which it was granted.

Although after a century of development its object, as defined in its statutes, still remains gainful banking activities, it has in fact become, under the sound arrangements instituted by the law, that of technical management of the currency. The Bank is allowed by its statutes, although its powers in this respect are not expressly defined, to carry out its special functions as a central bank responsible for the note circulation, for regulating the supply of credit and for administering the country's external reserves with the aim of preserving monetary stability.

The Bank's annual reports have frequently stated that monetary stability is its ultimate aim. This aim, however, cannot be effectively pursued unless state and Bank work together in constant collaboration. This co-operation is all the more essential since in Belgium monetary powers are, from a formal point of view at least, exercised by a number of different institutions. For example, the supervision of banks and of capital issues is carried out by the Banking Commission, while open-market policy is the responsibility of the Fonds des Rentes (Government Securities Market Stabilization Fund). As will be shown later on, however, the Bank's participation in the management of these bodies in fact enables the different strands of monetary policy to be woven together. Moreover, the monetary reserve ratio instituted by a decree of December 21, 1961 (see page 42), can be changed by the Banking Commission only on the proposal of the Bank.

III

STRUCTURE AND ADMINISTRATION

PRINCIPAL ORGANS

The Bank is directed by a Governor and its affairs are administered by a Board of Directors (Comité de Direction), assisted by a Council of Regency (Conseil de Régence). Its operations are supervised by a

Board of Censors (Collège de Censeurs) and a Government Commissioner. Certain powers are reserved to the General Council, comprising the Governor, the directors, the regents and the censors. There is also, at the Head Office of the Bank, a Discount Committee. The regulations governing the composition and functioning of the administrative organs reflect the Bank's mixed character, which the examination of its legal structure has already revealed.

GOVERNOR

Among the organs of management of the Bank, the Governor has from the outset occupied a special position, as a consideration of his function shows. Appointed by the King for a term of five years,[1] the Governor presides over the Board of Directors, the Council of Regency, the General Council and the General Meeting of shareholders, and ensures that decisions taken at these meetings are duly implemented.[2] He submits to the General Meeting the annual report on the operations of the Bank and the accounts. He is responsible for seeing that the organic laws, statutes and regulations of the Bank are observed and represents the Bank in legal cases. The Governor may suspend the execution of decisions of the Council of Regency pending submission to the General Council, and suspends and reports to the government any decision which would be contrary to the laws, statutes or regulations of the Bank, or to the interests of the state. If the government does not give a ruling within a fortnight of such a report, the decision in question may be carried out.[3]

If a conflict should arise between the Bank and the government, the Governor can be removed from office.[4] The government's right to nominate and remove the Governor is unrestricted both *de jure* and *de facto*.

BOARD OF DIRECTORS

The Board of Directors consists of the Governor and not less than three or more than six directors (there are at present four), appointed by the King for a term of six years. Such appointments by the Crown can, however, only be made from candidates put forward by the Council of Regency.[5] The government's choice is thus strictly limited. The directors may also be removed from office. If a conflict should arise, however, the power of the government is subordinate to that of the Council of Regency, on whose proposal new directors

[1] Organic law, Article 24, paragraph 1; Statutes, Article 44.
[2] Statutes, Article 61. [3] *Ibid.*, Article 62. [4] *Ibid.*, Article 44, paragraph 1.
[5] Organic law, Article 24, paragraph 2; Statutes, Article 48, paragraph 1.

have to be appointed. In the last resort, neither the Minister nor the Council of Regency can impose a decision on the other. The balance of power thus established is such as to safeguard the Bank against political interference in the carrying-out of its technical functions.

The Board of Directors is responsible for the management of the Bank. It takes decisions on all matters not expressly reserved for the Council of Regency, of which more will be said later. In an emergency it may alter the discount rate and the rate for advances but must refer such action to the Council of Regency at its next meeting.[1]

One of the directors is appointed by the King to act as Governor in the latter's absence. He has the title of Deputy Governor.[2]

A member of the Board of Directors may not be a member of either legislative chamber;[3] nor may he serve on the board of directors of any commercial company, with the exception of financial institutions which are subject to special legal provisions or placed under state guarantee or control and of certain international financial institutions. The acceptance of such functions is, however, subject to the approval of the Minister of Finance.[4]

COUNCIL OF REGENCY

The Council of Regency comes between the directors and the censors. It comprises the Governor, the directors and ten regents. The regents are elected by the General Meeting of shareholders for three years. The state, although holding half the share capital, cannot appoint candidates exclusively of its own choice. The majority of the names must be put forward by the main economic and social organizations. Under this system, two regents are chosen from among candidates proposed by the organizations that most fully represent labour; three from among those proposed by the organizations most fully representative of industry, trade and agriculture; two are chosen from the managing bodies of public financial institutions; and three are proposed by the Minister of Finance.[5] The government's power is thus limited to the selection of candidates from a double list. Furthermore, the regents can be

[1] Statutes, Article 63.

[2] Organic law, Article 23, paragraph 1; Statutes, Article 50.

[3] Organic law, Article 26.

[4] *Ibid.*, Article 27, paragraphs 1 and 2; Statutes, Article 51, paragraphs 1 and 2.

[5] Organic law, Article 24; Statutes, Article 53. The rules to be followed in proposing candidates are laid down in the Regent's decree of October 5, 1948 (*Moniteur* of October 8th).

removed from office only by a three-quarters majority of the shareholders present at the General Meeting, provided that this majority holds at least three-fifths of the shares.[1] This special majority requirement prevents the government from carrying too much weight in the matter of appointments.

The Council of Regency deliberates upon the questions that are within its competence in virtue of the law or the statutes and upon general questions relating to the Bank, the currency, credit and the economic development of the country. It fixes the rate and terms of discounts, advances and loans; nominates candidates for appointment as agents of the Government Cashier and fixes the amount of their surety bond; inspects the books of the Bank's offices at least once every six months; approves the annual report on the operations of the Bank to be presented by the Governor to the General Meeting;[2] makes up the balance sheet and submits it to the Board of Censors;[3] gives its views on the agreements fixing the maximum amount of the Bank's portfolio of public securities;[4] and fixes the second dividend which may be allotted to the shareholders.[5]

It may specifically delegate certain of its powers to the Board of Directors.

The Council of Regency meets at least once a week. During holiday periods meetings may be held at different intervals, provided that the total number of meetings during the year remains unchanged.

BOARD OF CENSORS

The Board of Censors consists of eight to ten members.[6] At present it numbers ten. The censors are elected by the General Meeting for a period of three years and candidates must be specially qualified in the field of financial supervision. There are no restrictions on the government's rights in the matter of nominating the censors, who are elected by a majority at the General Meeting.[7] Their dismissal, however, is subject to the same limitations regarding the prerequisite majority as in the case of the regents.

The function of the Board of Censors is purely supervisory, except that it participates, together with the Council of Regency and the Board of Directors, in the debates of the General Council.

[1] Statutes, Article 91. [2] *Ibid.*, Article 64. [3] *Ibid.*, Article 35, paragraph 1.
[4] Organic law, Article 13; Statutes, Article 20.
[5] Organic law, Article 21; Statutes, Article 38.
[6] Organic law, Article 23, paragraph 5; Statutes, Article 54, paragraph 1.
[7] Subject to the stipulation contained in Article 76 of the co-ordinated laws concerning commercial companies, which applies to the election of the censors and reads as follows: 'No one may cast a number of votes exceeding one-fifth of the votes attached to the total of shares issued or two-fifths of the votes attached to the shares represented at the meeting.' See the organic law, Article 24, paragraph 4; Statutes, Article 82, paragraph 2.

It has the right to supervise all operations of the Bank and to examine the books. It examines and, if there is occasion, approves the balance sheets and votes on the budget of expenditure, both being put before it by the Council of Regency. Decisions of the Council of Regency altering the rate or conditions of discounts and advances are submitted to the Board of Censors.[1]

The Board of Censors meets at least once a month. Any matter on which it is evenly divided is referred to the General Council for decision. In the absence of a quorum of censors, decisions on urgent matters are taken by the General Council.[2]

The same disqualification rules apply to both censors and regents. They may not be members of either legislative chamber[3] or take part in the administration or management of banks that come under the supervision of the Banking Commission. They are also prohibited from holding a post in a discount office.[4]

GENERAL COUNCIL

The Governor, the directors, the regents and the censors form the General Council.[5]

The General Council meets at least once a month to review the situation of the Bank. It makes the final decision on the distribution of the profits. On the basis of proposals made by the Council of Regency, it decides upon the regulations for internal management, as well as upon the general regulations concerning the organization of branches, offices, agencies and discount committees. The Minister of Finance is notified of these regulations.

As will be seen later, the General Council deliberates upon proposals for opening branches, offices, agencies and discount committees, upon their individual organization and upon all matters relating to the printing and issue of bank-notes.

It fixes the individual salaries and pensions of the Governor, the Deputy Governor and each of the directors. Such salaries and pensions may not include a share in the profits and no additional remuneration whatsoever may be paid by the Bank, either directly or indirectly. Similarly, it fixes the attendance fees of the regents and censors and their travelling allowances, if any, as well as the salaries and, if required, the surety bonds of the Secretary and the Treasurer.[6]

[1] Statutes, Article 67. [2] *Ibid.*, Article 68.

[3] Organic law, Article 26, paragraph 1; Statutes, Article 57.

[4] Organic law, Article 27, paragraphs 3, 4 and 5; Statutes, Article 51, paragraphs 3, 4 and 5.

[5] Organic law, Article 23, paragraph 6; Statutes, Article 69.

[6] Organic law, Article 25; Statutes, Article 70, paragraphs 6 and 7.

Except in the special circumstances in which the Council takes decisions instead of the censors in default of a quorum of the latter (see page 19), no deliberations of the General Council may take place in the absence of a majority of the members of the Council of Regency and Board of Censors.[1]

GOVERNMENT COMMISSIONER

To prevent government control over the Bank's activities from degenerating into continual interference, it has from the outset been exercised only at the highest level. The very delegation of supervisory powers to the Governor provides in itself one safeguard against the danger of excessive intervention. In view, however, of the duality of the functions entrusted to the Governor, the law also provides for the appointment by the King of a Government Commissioner to supervise all the Bank's operations. He suspends the application of any decision which would be contrary to the legislative or statutory provisions concerning the Bank or to the interests of the state and gives notice thereof to the Minister of Finance. If the Minister has not given any instructions within a week of the act of suspension, the decision in question may be put into effect.[2]

The Government Commissioner has the right at all times to investigate the situation of the Bank and to examine the books and the cash in hand. He may, when he thinks fit, attend in an advisory capacity the General Meeting, as well as meetings of the various boards of the Bank.[3] He reports annually to the Minister of Finance on his work.

His power lies essentially in his right of suspensive veto. It must, however, be emphasized that, through its Commissioner, the government has only a negative power of intervention in the management of the Bank. It has the power to prevent, but not to enforce, the taking of a decision. If a conflict should arise, neither the Bank nor the government can impose its views.

The Commissioner's supervisory powers are, above all, of psychological importance. He is to be regarded as a permanent official observer. In point of fact, it has only been when tension has developed between the Minister of Finance and the Governor or by virtue of his personality that the Commissioner has been able to play a rôle of any significance.

The salary of the Government Commissioner is fixed by the Minister of Finance by agreement with the administration of the Bank. The Bank is responsible for paying the Commissioner's

[1] Statutes, Article 71.
[2] Organic law, Article 30; Statutes, Article 76.
[3] Statutes, Articles 77 and 78.

salary and the fees of any technical experts whose services may be called on.[1]

GENERAL MEETING OF SHAREHOLDERS

As the official character of the Bank's activities has become more pronounced, the powers of the General Meeting of shareholders have declined. In view of the fact that since 1948 half the shares have been held by the state, the voting at the General Meeting has been made subject to special regulations when important matters are concerned in order to lessen the state's predominance.

The General Meeting, which represents the whole body of shareholders, is held on the last Monday in February. It hears the report of the management on the business of the preceding year and takes a decision regarding the balance sheet if this has not been approved by the Board of Censors with a majority of at least six. It elects the successors to, or re-elects, the regents and censors whose term of office is due to expire and fills any vacancies resulting from death, resignation or other cause.[2]

An Extraordinary General Meeting may be convened whenever the Council of Regency thinks fit. It must be called:

(1) when the Board of Censors or a body of shareholders representing at least one-tenth of the capital so requests;
(2) if the number of regents or censors falls short of an absolute majority, i.e. six in the case of regents and six (or five) in the case of censors.[3]

The General Meeting discusses:

(1) matters mentioned in the notices convening the meeting and submitted to it either by the Council of Regency or by the Board of Censors;
(2) any proposals for the agenda, signed by five members and communicated to the Council of Regency at least ten days before the meeting.

If the meeting admits the urgency of other proposals submitted by the Council of Regency, these are also discussed.[4]

Each of the 400,000 shares carries the right to one vote. All decisions are taken by an absolute majority of votes. If the votes are equally divided, the proposal is rejected.[5] Except in the case of the election of the censors, Article 76 of the co-ordinated laws concerning commercial companies is not applicable. This article stipulates that no one may cast a number of votes exceeding one-fifth of the votes attached to the total of shares issued

[1] Statutes, Article 76. [2] *Ibid.*, Article 83. [3] *Ibid.*, Article 84.
[4] *Ibid.*, Article 87. [5] *Ibid.*, Article 88.

or two-fifths of the votes attached to the shares represented at the meeting.

One case in which the absolute majority rule does not apply concerns the removal from office of a regent or censor; such a decision requires a three-quarters majority vote of all shareholders present, who must hold at least three-fifths of the shares. A second, more important, case relates to the main prerogative of the General Meeting, i.e. amendment of the statutes. For this purpose, as has already been mentioned, two majorities are necessary, viz. a numerical majority of the shareholders present or represented, and a majority of the votes attached to the total number of shares held by those present or represented at the meeting.[1]

DISCOUNT COMMITTEE

A Discount Committee meets every Thursday at the Head Office in Brussels to give its opinion on such matters concerning the Bank's discount operations as are submitted to it for examination. It does so in a purely advisory capacity.[2] The head of the Bank's Discount Office or his deputy attends the Committee's meetings.

The Discount Committee comprises between three and six members (who must be or have been professionally active in trade or industry) appointed for a period of two years by the General Council, which fixes their attendance fees and their travelling allowances, if any. Although such is not the case at present, the Committee may have as its chairman a director or an official nominated for the purpose by the Board of Directors. Regents and censors may serve on the Discount Committee.[3]

ORGANIZATION OF THE HEAD OFFICE

The Head Office of the Bank comprises the following departments and offices:

A. Treasurer General's Department:
   1. Central Cashier's Office
   2. Current Accounts Office
   3. Bill Holding and Collection Office

B. Credit Department:
   1. Discount Office
   2. Loans Office

C. Foreign Department:
   1. Foreign Exchange Office
   2. Exchange Control Office

[1] Statutes, Article 92, paragraph 4. [2] *Ibid.*, Article 74. [3] *Ibid.*, Article 73.

D. Government Securities Department:
   1. Securities Office
   2. Government Bond Market Office
   3. Government Cashier's Office

E. General Secretariat:
   1. Secretariat
   2. Administrative Organization Office

F. General Supervisory Department:
   1. Inspectorate
   2. Supervisory Office

G. Printing Department:
   1. Technical Office
   2. Administrative Office

H. Works and Maintenance Department:
   1. Premises Office
   2. Stationery and Supplies Office

I. Other Offices:
   1. Research Office
   2. Statistics Office
   3. Credit Research and Statistics Office
   4. Legal Office
   5. General Accounting Office
   6. Personnel Office
   7. Bank-Notes Office
   8. Health and Welfare Office

The Board of Directors may modify this structure if it is found necessary.

BRANCHES AND AGENCIES

The National Bank is represented in the Belgium–Luxemburg Economic Union by three branches (at Antwerp, Liège and Luxemburg) and forty agencies. It is authorized to open branches or agencies in the chief towns of the judicial districts, and also in places within the territory of the Belgium–Luxemburg Economic Union where the need is found to exist, by agreement with the government concerned.[1] Proposals for setting up branches and agencies are submitted to the General Council.[2]

All but three of the branches and agencies were opened during the period 1850–72. They are administered by managers and agents respectively, who, as well as carrying out certain operations on

[1] Organic law, Article 2, paragraph 2; Statutes, Article 2.
[2] Statutes, Article 70, paragraph 5.

behalf of the Bank, also act as Government Cashier in their branch or agency.

As officials of the Bank the managers and agents are nominated by the Board of Directors; as agents of the Government Cashier, on the other hand, they are appointed by the King on the proposal of the Council of Regency.[1]

In their capacity as agents of the Government Cashier, they have, *inter alia*, to carry out settlements with the post offices, handle purchases and sales of securities and subscriptions to public loans and see to the service of such loans. The agencies also handle payments on behalf of various semi-public credit institutions.

Among the operations carried out on behalf of the National Bank mention should be made of the supplying of bank-notes to private banks, public bodies, firms and individuals; the receiving of payments; the effecting of clearing arrangements with branches of private banks and the post offices; and miscellaneous business, such as the holding of securities in safe custody and the transferring of funds from one place to another.

Since the establishment of an extensive network of private banks, these operations are no longer indispensable to a region's economy. It is nevertheless useful to have a local agency of the National Bank available. This provides a sound system of decentralization and has a favourable influence on the general conditions on which banking operations are effected.

At the end of each day the managers and agents send an accounting statement of the day's operations to the Bank's Head Office. This statement is accompanied by supporting documents.

DISCOUNT OFFICES

A discount office or committee is attached to all branches and agencies in places where the government considers it necessary, after consulting the Council of Regency of the Bank.[2] At the moment there is only one discount committee, which is located in Brussels, while discount offices are attached to the three branches and to all but two of the agencies.

The discount offices are constituted in the form of partnerships, the members of which are approved by the General Council of the Bank.

Except in special cases admitted by the General Council, persons who have been or are employed in a bank or finance company, notaries and stockbrokers may not be members of a discount office.

[1] Co-ordinated laws regarding the functions of the Government Cashier, Article 5 (*Moniteur* of November 6, 1926); Statutes, Article 64, paragraph 4.

[2] Statutes, Article 3.

The purpose of the offices is to scrutinize and guarantee, on the joint and several liability of the partners, the discount business and applications for advances that they present, on behalf of their clients, to the Bank, the General Savings and Pensions Fund (Caisse Générale d'Epargne et de Retraite), the National Industrial Credit Bank (Société Nationale de Crédit à l'Industrie) and the National Fund for Business Credit (Caisse Nationale de Crédit Professionnel).

The above-mentioned institutions grant the discount offices guarantee commissions, the rate and method of collection being determined by agreements between the parties.

Every member of a discount office must put up a deposit as a surety for the commitments undertaken by the office. The amount of the surety deposit is fixed by the Board of Directors in proportion to the volume of commitments to which the office gives its guarantee.

With regard to the discounting business of the Bank, the offices may only present commercial bills that fulfil the customary eligibility requirements. These are discounted at the Bank's official rate. The paper presented by the discount offices is endorsed by the clients to the Bank direct; the offices do not discount these bills themselves, but merely guarantee them. The office's guarantee is given in a separate instrument. This guarantee cannot take the place of a signature when the bills bear the personal signature of a member of the office, unless the Board of Directors decides to the contrary.

In the event of non-payment at maturity or repudiation of the discounted bills, the offices are bound under their guarantee to pay them at once.

The Bank may make the acceptance of bills for rediscounting subject to the provision of such real or personal sureties as it considers that the office presenting the bills should obtain.

PUBLICITY

The arrangements providing for supervision of the Bank's operations are supplemented in a number of ways.

Thus, apart from the drawing-up of the annual balance sheet, the profit and loss account and the statement of the distribution of the profits, which must be published in the *Moniteur*,[1] the Governor sends a weekly statement to the Minister of Finance, in which the Bank's situation for the current week is compared with that for the preceding week. This statement is published in the *Moniteur*.[2] In addition, the Bank is required to publish a statement of the public

[1] Organic law, Article 31, paragraph 3; Statutes, Article 41, paragraph 1.

[2] Organic law, Article 31, paragraphs 1 and 2; Statutes, Article 42, paragraph 1

securities held by it at March 31st, June 30th, September 30th and December 31st.[1]

It should also be mentioned that the agreements between the Minister of Finance and the National Bank regarding the total volume of public securities which may be held by the Bank must be published in the *Moniteur* within a week of their being concluded.[2]

IV

POWERS AND ACTIVITIES

NOTE ISSUE

Apart from the coins and notes issued by the Treasury, which account for only a very small part of the money supply, the fiduciary currency is issued by the National Bank, as the sole bank of issue. Since its foundation in 1850 the National Bank has in fact held the privilege, but not a legal monopoly, of note issue; Parliament has the power to confer a right of issue upon other banks.

The Bank's notes have, since 1873, been legal tender. The monetary law of April 12, 1957 (*Moniteur* of April 18th), lays down that: 'The notes of the National Bank of Belgium shall be accepted as lawful currency by public institutions and private persons notwithstanding any agreement to the contrary.'[3] The Bank is temporarily exempted from the obligation of redeeming its notes in specie. The King may, however, by a decree resolved upon by the Cabinet, withdraw this exemption.[4]

Under the terms of the law, the franc, the Belgian monetary unit, has a par value of 19·74824173 milligrammes of gold, nine-hundred-thousandths fine.[5] The parity of the franc, which had been fixed since the war by a decision of the government alone without ratification by Parliament, can in future be changed only by the passing of a new law.

The Bank's notes are payable to bearer and are issued in denominations of 100, 500 and 1,000 francs. The design and text of the various denominations of bank-notes to be issued are submitted by the Bank to the Minister of Finance for approval.[6]

The issue of divisional money is made on behalf of the Treasury through the Monetary Fund.[7] The present ceiling for this issue is

[1] Organic law, Article 38, paragraph 2; Statutes, Article 42, paragraph 2.
[2] Organic law, Article 13; Statutes, Article 20.
[3] Monetary law, Article 3, paragraph 1.
[4] *Ibid.*, Article 4, paragraphs 1 and 2.
[5] *Ibid.*, Article 1.
[6] Organic law, Article 8, paragraph 1; Statutes, Article 25, paragraph 1.
[7] Law of June 12, 1930, by which a Monetary Fund was created (*Moniteur* of June 20th), amended by the law of April 14, 1933 (*Moniteur* of April 21st), and by the royal decree of August 14, 1933 (*Moniteur* of August 16th and 17th).

fixed at 7·5 milliard francs.[1] The amount of such currency in circulation has, however, never reached this figure and does not vary very much: in November 1962 it stood at 5·7 milliard francs (after deduction of an amount of 0·4 milliard held by the National Bank), i.e. 4 per cent of the fiduciary currency supply. It consists of 20 and 50-franc notes—which replaced the National Bank's notes of the same value in 1926 and 1935 respectively—and coins of 0·20, 0·25, 0·50, 1, 5, 20, 50 and 100 francs. Of the coins only the 100-franc piece is unlimited legal tender.[2]

The limit to the Bank's holdings of divisional coin and notes circulating on account of the Treasury was set at 700 million francs in accordance with the terms of letters exchanged between the Minister of Finance and the Bank, and the following conditions were attached to it by the decree of October 14, 1955:

(1) if the limit is exceeded in each of the weekly statements published during any given month, the Bank shall request the Treasury to redeem from it, on the date of the last statement for that month, the average surplus of the month in question;

(2) if, in spite of such redemption, the Bank's holdings of divisional coin and notes continue to total more than 700 million francs in the following month, the Bank shall request the Treasury to redeem from it, on the date of the last weekly statement of the second month, the total amount by which the contractual limit of 700 million francs is exceeded at that date.

Towards the end of the war the Bank was exempted from complying with the regulations concerning the cover for its note circulation until the return of more normal conditions allowed the statutory cover requirement to be restored.[3] This condition being fulfilled, the monetary law of 1957 laid down that the National Bank must maintain a reserve of gold equivalent to at least one-third of its total sight liabilities.[4] In fact the percentage of cover has generally varied between 41 and 53 per cent of the Bank's sight liabilities. For the remainder of the note circulation, the Bank is required to hold easily realizable assets.[5] This restriction, however, does not apply to the claim that Belgium has on the International Monetary Fund by

[1] Law of July 27, 1953, Article 1 (*Moniteur* of August 5th).

[2] Regent's decree of October 15, 1948, amended by the royal decree of October 16, 1951, Article 7 (*Moniteur* of October 26th).

[3] Legal decree No. 5 of May 1, 1944 (*Moniteur* of September 5th issued in London).

[4] Law of April 12, 1957, Article 6; organic law, Article 7, paragraph 2; Statutes, Article 30.

[5] Organic law, Article 7, paragraph 1; Statutes, Article 24, paragraph 2.

virtue of its quota as a member of the Fund. The Bank enters this claim in its books, as an asset, to the amount of the notes issued, credits given and gold payments made by it to the Fund, on behalf of the government, within the framework of Belgium's obligations under the terms of the Agreement establishing the International Monetary Fund (i.e. at present 6·7 milliard francs).[1]

OPERATIONS PROVIDED FOR BY THE ORGANIC LAW

The operations which the Bank is authorized to carry out are delimited[2] by the organic law and specifically enumerated in the Bank's statutes. These operations are as follows:[3]

(1) to discount, purchase or sell
  (*a*) bills of exchange and other commercial paper,
  (*b*) short and medium-term government securities;
(2) to buy and sell domestic government securities issued at long term and quoted on the stock exchange;
(3) to deal in gold and silver bullion;
(4) to grant advances
  (*a*) on gold or silver bullion or coins,
  (*b*) against government securities;
(5) to undertake the collection of bills;
(6) to rediscount abroad paper in its portfolio; to pledge its paper as security; to guarantee its paper or the discounts and advances connected therewith; to acquire assets or obtain credits abroad and to effect exchange operations on foreign markets;
(7) to accept money on current account and to take custody of securities, precious metals and gold and silver coins.

In addition, the Bank may carry out such operations as are necessary to facilitate movements of funds.[4]

The Bank acts, free of charge, as Government Cashier.[5] This entails receiving and making payments on behalf of the Treasury both in Belgium and abroad, as well as effecting all operations connected with government or government-guaranteed loans, including the issue and payment of coupons and redeemable securities and the servicing and custody of securities held by the

[1] Statutes, Article 24, paragraph 4.
[2] Organic law, Article 12, paragraph 1; Statutes, Article 18, paragraph 1.
[3] Organic law, Article 11; Statutes, Article 17.
[4] Organic law, Article 19; Statutes, Article 31.
[5] Organic law, Article 17; Statutes, Article 32; and royal decree of October 30, 1926, adopted in execution of the law of July 16, 1926 (*Moniteur* of November 6th).

government or of which the latter is trustee and of those owned by other bodies subordinate to the Treasury. The Bank also performs banking services for the General Savings and Pensions Fund—in particular holding its security portfolio. It may, upon authorization by the Minister of Finance, perform similar services for other semi-public credit institutions.[1] It attends to the day-to-day management of the Fonds des Rentes, keeps its accounts, handles its transactions and assumes the custody of its assets. Moreover, it operates the clearing houses which it helped to establish in Brussels and the provinces.

In its rôle as Government Cashier, the Bank is regarded as keeper of the state's accounts and is subject to the supervision of the Audit Office (Cour des Comptes).[2]

Apart from the Bank's non-interest-bearing consolidated claim of 34 milliard on the state resulting from the war,[3] the investment of a sum equal to the Bank's capital, reserves and amortization funds[4] and the assets of its pension fund,[5] the Bank's portfolio of public securities may not exceed 10,333 million francs.[6] Of this sum, a credit line of 10 milliard francs is reserved to the Belgian Government and one of 333 million francs to the Luxemburg Government.[7] The loans granted by the Bank bear interest at the discount rate for accepted bills domiciled at a bank. The sum of 2,465 million, representing that part of the government's debt to the Bank which was not consolidated when the Bank's balance sheet was reformed in 1948, does not, however, bear interest.[8] If special circumstances warrant it, in particular in the event of large withdrawals from the Postal Cheque Office or from the banks which the Treasury is unable to meet from its own resources, including the credit line of 10 milliard, the National Bank is to make available to the Treasury, in accordance with its needs, a special credit line of an amount

[1] Organic law, Article 18; Statutes, Article 33.

[2] Royal decree of October 30, 1926, adopted in execution of the law of July 16, 1926 (*Moniteur* of November 6th).

[3] Law of July 28, 1948, relating to the reform of the balance sheet of the National Bank, Article 3 (*Moniteur* of July 29th), amended by the law of June 19, 1959, Article 3 (*Moniteur* of June 20th).

[4] Organic law, Article 14; Statutes, Article 21.

[5] Organic law, Article 15; Statutes, Article 22.

[6] Organic law, Article 13; Statutes, Article 20; Agreement of September 14, 1948, between the Belgian Government and the National Bank of Belgium (*Moniteur* of September 18th); Agreement of April 15, 1952, between the Belgian Government and the National Bank of Belgium; and Agreement of the same date between the Luxemburg Government and the National Bank of Belgium (*Moniteur* of April 20th).

[7] Agreement of April 15, 1952, between the Luxemburg Government and the National Bank of Belgium, Article 1.

[8] *Ibid.*, Article 3, and Agreement of September 14, 1948, Article 3.

to be determined by a special agreement.[1] Provision is also made for the extension of special assistance to the Luxemburg Treasury.[2]

In practice, the Belgian Treasury's drawings on the credit line have generally varied between 6 and 10 milliard francs; the Luxemburg Treasury, on the other hand, has only once, in 1952, drawn upon the Bank's credit.

Apart from one attempt just before the Second World War, the Bank has never conducted open-market operations, although such action is not expressly precluded by the organic law. The body which is specifically concerned with open-market policy is the Fonds des Rentes, which will be considered in the section dealing with monetary policy.

A further point to be noted is that the Bank may, with the authorization of the Minister of Finance, acquire securities representing the capital of financial institutions which are subject to special legal provisions or are placed under state guarantee or control, and of the Bank for International Settlements, provided that the aggregate of such securities does not exceed an amount corresponding to its capital, reserves and amortization funds.[3]

The assets and liabilities appearing in the National Bank's balance sheet as a result of the gold and foreign exchange operations referred to at the beginning of this section consist mainly of gold and convertible currency holdings, and claims and commitments under payments agreements.

The Bank implements payments agreements on behalf of the government, the latter bearing the risks and paying all expenses, fees, interest and other relevant charges and receiving the incoming interest, etc.[4] The Bank, however, holds for its own account foreign

[1] Agreement of September 14, 1948, Article 2. An agreement dated February 1, 1963 (*Moniteur* of February 9th), provided for a special credit margin of 7·5 milliard in favour of the Treasury for the purpose of financing any loans which Belgium might be called upon to make to the International Monetary Fund on the basis of the decision dated January 5, 1962, of the Board of Executive Directors of the Fund and pursuant to the Belgian law of January 4, 1963 (*Moniteur* of January 18th), approving the Belgian Government's adherence to that decision.

[2] Agreement of April 15, 1952, between the Luxemburg Government and the National Bank of Belgium, Article 2.

[3] Organic law, Article 12, paragraph 2; Statutes, Article 18, paragraph 2. In fact the National Bank holds shares of the Bank for International Settlements and of the National Industrial Credit Bank.

[4] Nevertheless, the interest due to the Belgian Government from foreign borrowers, or from the Belgian Government to foreign creditors, in respect of credits or advances provided for under the terms of the European Monetary Agreement is paid to or by the Bank, as the case may be. (Agreement of April 16, 1959, between the Belgian Government and the National Bank.) With regard to advances granted by the Bank to foreign countries under bilateral payments agreements, the government allows the Bank interest at a rate equal to the discount rate for accepted bills domiciled at a bank (Agreement of July 1, 1959).

currency acquired from notes it has issued or credits it has granted within the framework of such agreements. The government guarantees the Bank against any exchange or other losses which it may incur in implementing these agreements. It also guarantees the Bank reimbursement of any unsecured loans or advances in Belgian francs which the latter may make within the framework of an international payments agreement. The Bank submits to the Minister of Finance a statement detailing all purchases and sales of foreign exchange carried out under the terms of exchange agreements during the course of the month after the transactions occur.[1]

A number of specific agreements have been concluded between the government and the Bank with a view to regulating the implementation of payments agreements. The agreements which are currently in force are that of April 16, 1959, relating to the execution of the European Monetary Agreement and the liquidation of the European Payments Union and that of July 1, 1959, relating to the implementation of bilateral payments agreements. Under the terms of the latter agreement the National Industrial Credit Bank reimburses the Bank for any claims on foreign countries which are contractually immobilized or consolidated for a period exceeding 120 days.

EXCHANGE CONTROL

Exchange control was introduced at the end of the Second World War and was made the responsibility of the Belgium–Luxemburg Exchange Institute, which is a public body with legal status.[2] The Institute's function is to draw up foreign exchange regulations, to ensure that the legal provisions and regulations concerning exchange control are implemented and to trace and establish cases of infringement. It is administered by a board of nine members, consisting of the Governor of the National Bank, who acts as chairman of the board, one member of the Board of Directors of the National Bank, the chairman of the Banking Commission, two members nominated by the Luxemburg Government and four members nominated by the Belgian Government.[3] The Minister of Finance has the right to supervise all the operations of the Institute. This supervision is effected by way of a government commissioner, who suspends and reports to the Minister any decision which would be illegal or contrary to the interest of the state.[4] The Institute has no administrative

[1] Decree-law No. 5 of May 1, 1944, amended by the laws of July 28, 1948, April 12, 1957, and June 19, 1959 (*Moniteur* of September 5, 1944, published in London, and *Moniteur* of July 29, 1948, April 18, 1957, and June 20, 1959).

[2] Decree-law of October 6, 1944, establishing an Exchange Institute (*Moniteur* of October 7th), amended by the decree-law of December 5, 1944 (*Moniteur* of December 7th), Article 1.

[3] *Ibid.*, Article 3.

[4] *Ibid.*, Article 4, paragraph 1.

staff of its own. Under the terms of an agreement concluded in execution of the decree-law of October 6. 1944, establishing the Institute, its administration and day-to-day management are entrusted to the National Bank.

The implementation of foreign exchange regulations has been decentralized by virtue of the system of authorized banks. Into this category fall those banks and other establishments authorized by the Exchange Institute to conduct foreign exchange transactions and to open foreign exchange accounts.[1] These authorized banks alone enjoy the right to perform these operations. They must, however, strictly adhere to the regulations laid down by the Institute.

The current regulations of the Exchange Institute make a clear distinction between operations on the controlled exchange market and those on the free market. The former are subject to the terms and conditions of settlement laid down in the regulations and are always carried out through the medium of the authorized banks. Operations on the free market, however, are not subject to restrictions and may be carried out either through the banks or not and either within the Belgium–Luxemburg Economic Union or in other countries.

Currency acquired on the controlled market may be utilized by the authorized banks only for the following purposes:

(*a*) current payments to foreigners on behalf of nationals or residents;
(*b*) credits in foreign currency to nationals or residents for current payments;
(*c*) all forms of short-term investment in foreign currency;
(*d*) arbitrage dealings in foreign currencies on the controlled market.

The authorized banks must keep separate accounts for all their foreign exchange transactions on the controlled market.

CAPITAL ISSUES CONTROL AND SUPERVISION OF THE BANKS

In Belgium the central bank is not vested with the right to exercise control over the banks. Under the royal decree No. 185 of July 9, 1935 (*Moniteur* of July 10th),[2] the supervision both of the banks

[1] Regent's decree of October 6, 1944, relating to foreign exchange control (*Moniteur* of October 7th), Article 1, last paragraph.

[2] Amended by the royal decrees of March 26, 1936, October 22, 1937, and November 30, 1939, and by the decree-laws of October 6, 1944, and December 23, 1946 (*Moniteur* of March 28, 1936, October 30, 1937, December 1, 1939, October 7, 1944, and January 1, 1947).

and of public issues of securities was entrusted to the Banking Commission, an autonomous body whose organization is governed by regulations approved by royal decree. The banks are, nevertheless, required to communicate to the National Bank certain information which may assist it in the formulation of its policy.

The Banking Commission consists of a chairman and six members, who are appointed and may be removed from office by a royal decree countersigned by the Minister of Justice, the Minister of Finance and the Minister for Economic Affairs. Two members are appointed from a list of three candidates drawn up by the National Bank and the Rediscount and Guarantee Institute (Institut de Réescompte et de Garantie).[1] At the present time the Deputy Governor of the National Bank is a member of the Banking Commission.

CAPITAL ISSUES CONTROL

The decree of July 9, 1935, assigns to the Banking Commission the function of keeping a check on public issues of securities. Anyone intending to advertise or offer for sale, to sell or to issue to the public either stocks, shares or participations in a company, or bonds, must notify the Banking Commission thereof a fortnight in advance. Similar notice must be given before an application is made for quotation on a Belgian stock exchange. Such notice must be accompanied by the relevant documentation.[2]

The Banking Commission may, if circumstances call for it, prohibit for a period not exceeding three months the advertisement, offer or sale of an issue to the public. It may make its decision public. The Minister of Finance may, at the request of the Banking Commission, forbid the admission to official stock exchange quotations of stocks and shares offered or sold to the public in contravention of the Commission's decision.[3]

The Commission does not, therefore, have the power to prohibit an operation once and for all. It may only give advice and sometimes postpone or modify an operation which is contemplated. In fact, it endeavours to throw more light on the position of companies having recourse to the capital market and on projects for which the public's financial support is sought. It has also been taking systematic steps with a view to making companies observe the rules which ought to govern the conduct of their affairs, particularly when they finance themselves with money borrowed from the public.

[1] Royal decree of July 9, 1935, Article 37. [2] *Ibid.*, Articles 26 and 27.
[3] *Ibid.*, Article 32.

SUPERVISION OF THE BANKS

Under the terms of the royal decree of July 9, 1935, and subsequent amendments, the banks are required to observe certain regulations regarding their minimum capital, the prohibition of the establishment of banks with variable capital, the investment of statutory reserves and the composition of organs of management (limitations and disqualifications). This decree contains provisions relating to the general organization of the supervision of the banking system and to the powers and duties of the supervisors responsible for carrying it out. It prohibits mixed banks and the exploitation of financial power as a means of influencing public opinion.[1] It also lays down that mergers of banks are subject to authorization by the Banking Commission.

Of special interest in this context is that the decree empowers the Banking Commission periodically to establish, by way of regulations that are submitted for approval to the Minister of Finance and the Minister for Economic Affairs, the ratios which the different categories of bank must keep:

(*a*) between their liquid resources and their readily mobilizable assets, or certain components of such assets, on the one hand, and their sight and short-term liabilities on the other; and
(*b*) between their capital and reserves and the sum total of either their deposits or all their sight and short-term liabilities.[2]

The Banking Commission did not make use of these powers until 1946. In February of that year, however, it introduced regulations, which, in their fundamentals, remained in force until 1962, requiring the banks to employ part of their deposits in Belgian francs for the benefit of the Treasury.

There were drawbacks inherent in this system. Although the Treasury automatically benefited from the fundamentally expansionary trend of bank deposits, it was obliged, when deposits were withdrawn, to redeem Treasury paper held by the banks. The most notable case in point occurred in the autumn of 1957. For this reason a reform was introduced in November 1957 which did away with this automatic link and fixed the total of Treasury certificates held at that time by the banks at a maximum level of 28·9 milliard. This debt was made statutory. A special loan issue totalling 28·9 milliard was made in two tranches: one of 'A' certificates at

[1] The banks are required to submit a monthly statement to the National Bank listing their expenditure on publicity and any allowances, subsidies and free services which they have granted (royal decree of July 9, 1935, Article 15, paragraph 4).

[2] Royal decree of July 9, 1935, Article 11, paragraph 1.

one year to a total of 20 milliard, the other of 'B' certificates at four months. It was further agreed that if, owing to a decline in their deposits, the banks did not renew certificates of this special issue at maturity, the Fonds des Rentes would subscribe an equivalent amount of such certificates. If deposits were to rise above their level at the end of October 1957, supplementary partial cover for deposits in Belgian francs at up to one month would no longer be provided by Treasury paper but by certificates of the Fonds des Rentes or by deposits with the National Bank.[1] If the Fonds des Rentes declined to issue certificates, the banks would be obliged to make deposits at the National Bank.

The liquidity ratios varied according to the category of bank. For the big banks the position up to the end of 1961 was as follows:

LIQUIDITY RATIO

Composition	*Rate*
Cash Deposits at the National Bank, with the Postal Cheque Office[2] and the National Fund for Business Credit[3] minus: unsecured day-to-day loans and bankers' advances Day-to-day loans against security[4] (up to a maximum of 2 per cent of liabilities)	at least ·4 per cent of liabilities in Belgian francs at up to two years

SOLVENCY RATIO

Composition	*Rate*
Own resources	at least 5 per cent of current liabilities as shown in the annual balance sheet

[1] Ministerial decree approving the Banking Commission's decree of November 9, 1957, concerning banks' liquidity ratios (*Moniteur* of November 10, 1957).

[2] Office des Comptes Chèques Postaux.

[3] Caisse Nationale de Crédit Professionnel.

[4] Secured by government securities or rediscountable commercial bills deposited with the National Bank. Institutions of the public sector enjoy in respect of their commitments the general guarantee of the state.

COVER RATIO

Liabilities to be covered	*Cover assets*	*Rate*
A. Belgian franc liabilities at up to one month	(*a*) *Partial cover* Balances at the National Bank not earmarked for the liquidity ratio Treasury certificates: 'A' and 'B' issues Certificates of the Fonds des Rentes	50 per cent
	(*b*) *Diversified cover* All the assets eligible as partial cover, plus: Liquid assets (including secured call money) All bills in Belgian francs issued or guaranteed by the state (up to three years), including Treasury certificates at very short term and Treasury certificates issued by tender Credit balances on accounts, guaranteed by the state, with public credit institutions and credit balances on accounts with the National Industrial Credit Bank	15 per cent
	(*c*) *Global cover* = (*a*) + (*b*)	65 per cent
B. Liabilities in Belgian francs at more than one month but less than two years	All the assets eligible as partial cover and diversified cover for liabilities at up to one month, plus: Holdings of Belgian franc loans issued or guaranteed by the state, regardless of maturity	65 per cent

A decree of the Banking Commission dated December 21, 1961 (*Moniteur* of December 30th), cancelled with effect from January 1, 1962, these liquidity and cover requirements. Under transitional provisions embodied in the decree, however, the exemption from cover requirements was limited to any future increase in deposits.

(*a*) A bank was not to reduce its holdings of 'A' certificates below the level at which they stood when the new arrangements came into force.

(*b*) Except in those cases where current liabilities fell below the base figure described below—in which case the requirement was reduced proportionately—a bank was not to reduce the total of its liquid assets below a given level. This level was

determined by applying a percentage ratio of 65, 60 or 50 per cent, depending on the category of bank, to the average monthly total of liabilities subject to cover requirements as resulting from the end-of-month returns for the months January to October 1961.

A second decree of the Banking Commission dated December 21, 1961 (*Moniteur* of December 30th), instituted a monetary reserve ratio, which will be discussed in the section on monetary policy.

With effect from January 1, 1963, a decree of the Banking Commission (*Moniteur* of January 12th) cancelled the transitional provisions under which the banks were still required to maintain minimum holdings of government paper.

The final stage in eliminating the effects of wartime inflation on the structure of the banks' assets was entered upon with the issue of the royal decree of December 20, 1962 (*Moniteur* of December 22nd), which modified the terms of the Treasury certificates of issue 'A' of the special loan designed to provide cover for the liabilities of the banks. These certificates have been converted into non-marketable securities of a new special loan which is divided into three tranches of 10, 5 and 4·8 milliard respectively; the rate of interest for the first tranche has been raised from 1 15/16 to 3·5 per cent with effect from January 1, 1962; the rate for the second tranche will be raised to the same level after four years and that for the third tranche after nine years. Since the rate of 3·5 per cent is still below market levels, there is provision for acceptance of the securities of the new loan in payment for subscriptions to future long-term loan issues made by the government; the conditions of such conversions will, however, have to be decided upon in each case, in order to ensure that the operations do not affect budget charges.

With regard to the part played by the National Bank in the supervision of the banks, it may be pointed out that, in addition to the statement of their expenditure on publicity,[1] the latter must submit to the National Bank an annual balance sheet with a detailed profit and loss account and a monthly statement of their assets and liabilities. The National Bank publishes every quarter an overall survey of the banks' positions. In addition, the banks must as a matter of routine inform the National Bank and the Banking Commission of any application for credit which they receive for sums exceeding 1 million francs. When requested, either by the National Bank or by the Banking Commission, they submit to both bodies simultaneously a statement of the credits of all types granted by them to their customers as well as the amount of such credits not yet taken up.[2]

[1] See footnote 1 on page 34. [2] Royal decree of July 9, 1935, Article 12.

At the Banking Commission's request, the Bank may undertake enquiries, audits and evaluations in certain cases provided for by the decree of July 9, 1935.[1]

Subject to the approval of the Minister of Finance and the Minister for Economic Affairs and to the agreement of the National Bank, the Banking Commission may fix the maximum interest rates applicable to certain categories of credit operation.[2]

V

MONETARY POLICY

THE INSTRUMENTS OF MONETARY POLICY

To help it accomplish the task of preserving monetary stability, which has fallen to it by tradition rather than by formal assignment, the National Bank has the following means at its disposal:

(1) discount rate policy;
(2) intervention on the money market;
(3) the monetary reserve ratio;
(4) operations on the foreign exchange market;
(5) qualitative and quantitative controls;
(6) its position as adviser to the government and the banks.

DISCOUNT RATE POLICY

The National Bank in fact applies four discount rates depending on the quality of the paper in question, viz.:

(*a*) a rate for accepted bills domiciled at a bank, warrants and bankers' acceptances previously certified by the National Bank (3½ per cent since December 6, 1962, except for acceptances in respect of exports, which are discounted at the rate of 2¾ per cent);
(*b*) a rate for accepted bills not domiciled at a bank (4 per cent);
(*c*) a rate for unaccepted bills domiciled at a bank (4½ per cent);
(*d*) a rate for unaccepted bills not domiciled at a bank and for promissory notes (5 per cent); advances secured by public securities are also subject to this rate.

However, advances against Treasury certificates and certificates of the Fonds des Rentes are made at lower rates, which at the moment are as follows:

3½ per cent for Treasury certificates and certificates of the Fonds des Rentes with a currency period of not more than 130 days;
4 per cent for Treasury certificates with a currency period of more than 130 but not more than 366 days.

[1] Royal decree of July 9, 1935, Article 39. [2] *Ibid.*, Article 11, paragraph 2.

The first of these four rates is the official discount rate. It is by far the most important on account of the volume of paper to which it applies, its bearing on market rates and the psychological effects of alterations in it. Indeed, changes in the rate indicate the line of monetary policy which the authorities intend to pursue.

At the time of the reform of the money market in 1957 the rate for Treasury certificates of issue 'B' (held by the banks as statutory cover),[1] the rate for certificates of the Fonds des Rentes (also taken up by the banks as part of their statutory cover) and the interest rates paid by the banks on time deposits in Belgian francs were formally tied to the official discount rate.

This rigid link between the various interest rates and the discount rate was abandoned at the end of 1961. Since then the rates have fluctuated, under the supervision of the monetary authorities, in accordance with the supply of and demand for loanable funds. The certificates of the Fonds des Rentes are now issued at a single rate by weekly tender. The rates for 'B' certificates follow those for certificates of the Fonds des Rentes. Finally, changes in the banks' deposit rates are henceforth to be decided by agreement between the National Bank and the Belgian Banking Association.

The discount rates of the Rediscount and Guarantee Institute are more or less directly dependent on the Bank's discount rate, since the Institute has to have recourse to the Bank for such of its financial needs as are not covered by the day-to-day money available. Hence its rates lie between the call-money rate and the official discount rate.

Similarly, the interest rate for credits granted to individuals and enterprises is often fixed by agreement in terms of the National Bank's discount rate.

It should be noted that, when commercial bills are discounted directly at the National Bank by the endorsing bankers, the discount rate does not assume a penal character. When, however, the bills have been discounted on the unofficial market at the more favourable rate applied by the Rediscount and Guarantee Institute and the latter, through lack of sufficient liquid funds, has to have recourse to the rediscounting facilities provided by the National Bank, the official discount rate is in this case a penal rate. It may be recalled that the Institute was founded at the time of the banking reform of 1934–35. Its main activity is the mobilization of commercial paper on more generous terms than those offered by the National Bank. Out of its own resources it finances only acceptances certified by the National Bank. In the case of uncertified acceptances, it merely acts as intermediary.

Discount rate policy can be directly effective only if the market is

[1] See pages 34–35 above.

'in the bank'. In point of fact, except in periods of abundant liquidity such as the present one, which has persisted ever since 1959, the Belgian banks have always had to have direct and heavy recourse to the National Bank.

INTERVENTION ON THE MONEY MARKET

In Belgium the general public does not have access to the market in short-term government securities. Indeed, it is not, in the true sense of the word, a market at all.

The following categories of short-term government securities may be distinguished:

(*a*) Treasury certificates at four months given to the National Bank against advances granted by it as part of the credit line of 10 milliard francs.

(*b*) Treasury certificates at very short term (one to three months), taken up in the first instance by the National Bank and resold by it to the extent warranted, in its view, by market conditions; these securities are negotiable among banks, financial institutions of the public sector and certain semi-public enterprises. Any amount which the Bank might decide to hold itself would have to be deducted from the credit line of 10 milliard reserved to the Treasury.

(*c*) Treasury certificates (at six, nine and twelve months) issued by tender on the market, as defined above in sub-paragraph (*b*), but not purchased by the National Bank. The amount of certificates to be issued is fixed by agreement between the Minister of Finance and the National Bank, who also decide upon the allotment of the certificates. The allotments are sold at different rates in accordance with the bids made by subscribers to the issue.

(*d*) Certificates issued under special agreements concluded with each institution or group of institutions and subscribed by the banks—particularly the former 'A' (one-year) certificates of the statutory cover[1]—and by semi-public bodies.

(*e*) The banks' 'B' Treasury certificates, issued under the same conditions with respect to term and interest as the certificates of the Fonds des Rentes. Since the beginning of 1962 these certificates have been issued by weekly tender at a single rate. They run for four months.

The National Bank does not intervene, as a buyer or seller, in order to regulate the market for Treasury certificates or certificates of the Fonds des Rentes.

[1] See page 36 above.

Although it is permitted by its statutes to discount certificates in circulation, the total discounted would have to be deducted from the credit line of 10 milliard available to the Treasury. Nowadays the Bank only considers undertaking this form of mobilization in exceptional circumstances.

The Bank is, however, statutorily authorized to intervene, as a buyer or seller, in the market for long-term domestic government securities.[1] However, after one venture into open-market operations, in 1937, it has ceased to intervene in this market since the creation, in 1945, of the Fonds des Rentes, an autonomous body whose commitments are guaranteed by the state.

This body occupies a very special position on the Belgian money market. Up to 1957 its task was to regulate the market for medium and long-term government paper. It did not, however, pursue a genuine open-market policy. One of the objects of the money-market reform of November 1957 was to enable it to do so. Since then it has been able to issue certificates of its own which the banks may hold as cover for their deposits, and to obtain credit from the National Bank against security outside the credit line of 10 milliard reserved to the state.

The law of June 19, 1959 (*Moniteur* of June 20th), specifically authorizes the Fonds des Rentes to carry out open-market operations in government securities and extends the authorization, which had previously applied only to transactions in medium and long-term securities, to the short end of the market.

At the same time, the *masse de manœuvre* of the Fonds des Rentes was increased; the National Bank made available to it a credit line of 2 milliard on current loan account, distinct from that of the Treasury. In addition, the Bank having agreed to take over from the Treasury the financing of Belgium's gold subscription to the capital of the International Monetary Fund, the counterpart thereof (2·8 milliard francs) was put at the disposal not of the Treasury but of the Fonds des Rentes. These additional funds may not, however, be used to finance the Treasury. When the Fonds des Rentes intervenes on the government bond market for the direct benefit of the state, the Bank, by agreement with the Treasury, does not grant it advances but will accept cash certificates (*bons de caisse*) for discounting, which count towards the credit line of 10 milliard. This was the case for two short periods in 1958.

The management of the Fonds des Rentes is undertaken by a committee of six members, appointed by the King, three of whom are proposed by the National Bank and three by the Minister of Finance. When the votes of the committee are equally divided, the decision rests with the Minister of Finance, but the latter must

[1] Statutes, Article 17, paragraph 9.

communicate to Parliament the arguments and views of the members of the committee as well as his own decision.[1]

THE MONETARY RESERVE RATIO

Up to the end of 1961 the instrument of a monetary reserve ratio had not been used in Belgium. The 4 per cent liquidity ratio introduced in 1946 was designed to consolidate and strengthen the positions of the individual banks; and the system resulting from the 1957 reform of the money market lacked the flexibility of a reserve ratio system which enables the monetary authorities to control the lending capacity of the financial institutions by directly influencing their liquidity.

A reserve ratio system was introduced under the Banking Commission's second decree of December 21, 1961 (*Moniteur* of December 30th), which was approved by the Minister of Finance and the Minister for Economic Affairs. Under this decree the Commission is authorized to fix, on the proposal of the National Bank, the proportion of the banks' various categories of monetary and quasi-monetary liabilities that must be held in the form of special sight deposits at the Bank, sight balances with the Fonds des Rentes or government securities of a special type deposited with the Bank.

The monetary reserve ratio may not exceed 20 per cent in the case of sight liabilities and liabilities at up to one month, and 7 per cent in the case of liabilities at more than one month and savings deposits. The ratio may not be raised by more than three percentage points in any thirty-day period without the approval of the Minister of Finance and the Minister for Economic Affairs.

Banks, however, are not the only financial intermediaries whose lendings may give an undesirable boost to demand. Private and public enterprises administering quasi-monetary funds may also cause an untimely return to circulation of idle funds they have taken up for the purpose of granting credits. Consequently, it is contemplated gradually extending the monetary reserve ratio system to all bodies which hold quasi-monetary funds.

OPERATIONS ON THE FOREIGN EXCHANGE MARKET

In the controlled foreign exchange market, the balance between the supply of and demand for foreign currencies is continuously maintained by the intervention of the National Bank, which has to observe the upper and lower limits on either side of parity laid down by the International Monetary Fund.

[1] Law of June 19, 1959, Article 8, paragraph 3.

In the free market, the Bank is under no obligation to intervene. If the Bank considers intervention inexpedient, the market must itself maintain equilibrium by a spontaneous reduction in demand or increase in supply brought about by a change in the exchange rate. Such a change may, perhaps, give rise for a while to divergences, even substantial ones, from the parities, but such divergences on the free market do not affect either operations or exchange rates on the controlled market. They tend, in any case, to resolve themselves as soon as the transient causes of disequilibrium begin to disappear.

The National Bank does not carry out forward transactions with the private banks. For a few years following the Second World War it regularly supplied the private banks with foreign exchange for forward delivery at a premium rate which was progressively raised to the level of the discount rate. This action ceased as soon as the restrictions on international payments were removed and the foreign exchange markets had become more organized.

QUANTITATIVE AND QUALITATIVE CONTROLS

The National Bank exercises a qualitative control through the medium of its discount policy. Indeed, to qualify for discounting, the paper presented must fulfil certain eligibility requirements, one of which is statutory and hence invariable. This is the restriction contained in Article 19 of the Statutes, to the effect that the only bills discountable by the Bank are commercial bills maturing within 120 days and guaranteed by the signature of three solvent persons. One of the signatures may, however, be replaced by a collateral security.[1] The other conditions of eligibility, which are laid down by the Bank itself, define the kind, quality and term of the commercial paper which the Bank will accept for rediscounting. Thus, for several years it has, with the exception of certified bankers' acceptances, refused to discount commercial bills which have more than 120 days to run. Within this four-month limit, the Bank has drawn up standards with regard to the length of life of bills to be presented to it for rediscounting, which vary according to the activities financed by the paper. Similarly, it will not accept bills financing hire-purchase operations.

With regard to quantitative control, the rediscount ceilings established for the deposit banks determine the maximum extent to which they can have recourse to the National Bank. These ceilings are calculated in relation to the banks' own funds (capital and reserves). In actual fact, they have been reached only in exceptional

[1] Commercial bills bearing two signatures may, however, be accepted for discounting in special cases defined in the regulations drawn up by the General Council and approved by the Minister of Finance (Statutes, Article 19, paragraph 2).

circumstances and cannot be regarded as an important instrument of monetary policy.

The Bank has also set ceilings limiting, for each bank, the granting of its special visa, i.e. its formal undertaking to accept for discounting bills thus certified when they do not have more than 120 days to run. It may be recalled that these bills are negotiable on the unofficial market at more favourable rates. Consequently, the special visa provides the Bank with a means not only of applying a quantitative control but also of pursuing a selective policy designed to facilitate the financing of certain categories of export and import operations.

ADVISER TO THE GOVERNMENT AND THE BANKS

As the government has very wide monetary and financial powers, it is only natural that the National Bank should act as adviser in certain fields where it does not itself directly play an active part. It seeks in this way to ensure the necessary harmony between the different aspects of monetary policy.

Its position as adviser is not explicitly sanctioned by legislation. It is, however, implicitly recognized by the appointment of board members or other high officials of the Bank to the managing boards of the Exchange Institute, the Banking Commission, the Fonds des Rentes and various public credit institutions. The Bank, moreover, provides the chairman of the Council of the Credit Institutions, whose function is to co-ordinate the credit policy of semi-public credit institutions and to keep the government informed on such matters. The public issue by tender of Treasury paper provides a further example of the Bank's rôle as adviser to the government; the Bank and the Minister of Finance fix the allotment of such paper by mutual agreement.[1]

The Bank's views are presented to the government with the utmost discretion, either by letter or by word of mouth. If the Governor considers it necessary to express publicly the Bank's views on the government's economic and financial policy, he does so in his annual report or in his statement to the General Meeting of shareholders.

The statutory provisions and regulations concerning the supervision of the banks do not permit the National Bank to make recommendations to the private banks. On several occasions, however, particularly when the discount rate has been raised, the Bank has been led to ask the private banks for their co-operation in the conduct of its policy. It has quite frequently requested them to exercise a certain selection in their credit-granting. The banks have never failed to co-operate and to follow the advice of the National Bank in an atmosphere of mutual confidence.

[1] See page 40, sub-paragraph (*c*) above.

GOVERNMENT POWERS WITH REGARD TO MONETARY POLICY

A description of the powers which the government holds within the National Bank through its Commissioner and as a shareholder at the General Meeting has already been given at the beginning of this chapter. These powers do not, however, allow the government to exercise a determining influence upon the course of policy pursued by the Bank. Although the government is entitled in certain cases to object to a decision, it has, on the other hand, no power to compel the Bank to take any given action. Even this negative right is strictly limited; it has never proved a hindrance to the Bank in carrying out its functions as it itself conceives them.

In spite of its *de facto* majority at the General Meeting, the government cannot enforce a change in the Bank's statutes unless it has the support of a number of other shareholders. On the other hand, no amendment to the statutes can be passed without the government's agreement.[1] In this respect also the latter's power is essentially negative.

In other branches of monetary policy the government has positive and clearly defined powers. This applies particularly to open-market policy, which falls within the province of the Fonds des Rentes. This body is managed jointly by representatives of the Bank and of the government, but where opinion is divided the government may impose its views, provided that it communicates to Parliament the different opinions put forward within the management of the Fonds.[2]

The government also has considerable powers with regard to supervision of the banks. It should be mentioned particularly that the regulations in respect of liquidity ratios, which are laid down by the Banking Commission, must be submitted to the government for approval.[3]

Similarly, the monetary reserve ratio to which the banks may be made subject may not be raised by more than three percentage points in any thirty-day period without the government's approval.[4]

Finally, since the marked expansion of the public credit sector, the government has come to assume other responsibilities in the monetary sphere. It is true that the semi-public credit institutions enjoy a large measure of autonomy, but this is moderated, and a certain influence put in the hands of the government, by the provisions relating to the appointment of the managing officers and to the supervision of the institutions' operations.

[1] See page 22 above. [2] See pages 41–42 above. [3] See page 34 above.
[4] See page 42 above.

ANNEX

BANQUE NATIONALE

WEEKLY

as at December 28,

Assets	In millions of francs
1. Gold	68,248
2. Foreign exchange	12,924
3. Foreign exchange and gold receivable	2,935
4. International agreements:	
(*a*) European Payments Union	251
(*b*) European Monetary Agreement	55
(*c*) International Monetary Fund	6,739
(*d*) Other agreements	—
5. Debtors in respect of forward transactions in foreign exchange and gold	12,341
6. Commercial bills	7,811
7. Advances against collateral	2,712
8. Public bills:	
(*a*) Treasury certificates	5,090
(*b*) Bills issued by institutions whose liabilities are guaranteed by the government	—
(*c*) Other Belgian public bills	—
9. Divisional money and minor coin	339
10. Balances at the Postal Cheque Office	1
11. Consolidated claim on the state	34,000
12. Public securities	2,627
13. Real property, equipment and movables	1,539
14. Securities of the Staff Pensions Fund	1,224
15. Sundry items	2,172
Total	161,008
Memorandum account:	
Postal Cheque Office: Balance held for account of the Minister of Education and Culture	1,061

DE BELGIQUE

RETURN

1962

Liabilities	In millions of francs
16. Bank-notes in circulation	137,589
17. Current accounts:	
A. Treasury:	
Ordinary account	24
Special anti-cyclical tax	27
Special E.P.U. liquidation account	—
B. Foreign banks: ordinary accounts	390
C. Miscellaneous current accounts	1,899
18. International agreements:	
(*a*) European Monetary Agreement	187
(*b*) Other agreements	394
Total sight liabilities	140,510
19. Foreign exchange and gold payable	15,269
20. Staff Pensions Fund	1,224
21. Sundry items	1,378
22. Capital	400
23. Reserves and amortization accounts	2,227
Total	161,008
Memorandum account:	
Balance held for account of the Minister of Education and Culture at the Postal Cheque Office	1,061

EXPLANATORY NOTE ON THE WEEKLY RETURN

ASSETS

1. GOLD

This item comprises the gold (bullion and coin) which is held either at the Bank itself or under earmark at foreign central banks.

The holdings are valued at the price of 56,263·7994 francs per kilogramme of fine gold. This price is based on the definition of the franc given in the monetary law of April 12, 1957: 'The franc, the Belgian monetary unit, has a par value of 19·748241 73 milligrammes of gold, nine-hundred-thousandths fine.'

2. FOREIGN EXCHANGE

The amount entered under this heading corresponds to the equivalent in Belgian francs of the Bank's balances in foreign currencies convertible into gold or into dollars held with its correspondents abroad, and the foreign bank-notes in the Bank's own tills.

3. FOREIGN EXCHANGE AND GOLD RECEIVABLE

This item represents the equivalent in Belgian francs of the foreign exchange that has to be delivered to the Bank by sellers of forward exchange. The counterpart on the liabilities side is the item 'Foreign exchange and gold payable' (No. 19).

4. INTERNATIONAL AGREEMENTS (law of July 28, 1948)

Under the law of July 28, 1948, payments agreements are executed on behalf of and under the guarantee of the government.

On April 16, 1959, an agreement was concluded between the Belgian Government and the Bank relating to:

(1) the execution of the European Monetary Agreement of August 5, 1955, which came into force on December 29, 1958;
(2) the liquidation of the European Payments Union.

(*a*) *European Payments Union.* Under the terms of the above-mentioned agreement the Bank receives and pays on behalf of the government all the amounts receivable or payable under the bilateral amortization agreements; for this purpose it has opened a special account in the name of the Treasury called the 'Special E.P.U. liquidation account' (see the note to item 17 A (3)).

The difference between the amounts received by Belgium and the amounts paid by Belgium to foreign countries is used to reduce by a corresponding amount the Bank's claim arising out of the E.P.U., the government having undertaken not to employ this balance for any other purpose.

The net amount of the claim on the E.P.U. is thus equal to the difference between the amount entered under this item and that appearing under the liability item 'Treasury: Special E.P.U. liquidation account'.

(*b*) *European Monetary Agreement.* Under this item are entered the advances in Belgian francs that may be granted by the Bank to the central banks of member countries of the E.M.A. in accordance with the provisions of the Agreement.

(*c*) *International Monetary Fund.* This item originated in operations carried out during the second half of 1959 in accordance with agreements concluded between the government and the Bank on August 1, 1959, and October 14, 1959, defining the terms and conditions on which the Bank would assist in financing the government's obligations towards the International Monetary Fund.

A sum of 4,388 million francs represents the countervalue of the gold paid into the I.M.F.; it corresponds to 25 per cent of Belgium's present participation in the Fund, plus the reimbursement by the Bank to the government of its payment in Belgian francs to the Fund, representing 1 per cent of Belgium's quota.

In 1961, following drawings on the I.M.F. by the United Kingdom and the Republic of Argentina, the Bank made payments to those countries on behalf of the Belgian Government of 3 milliard and 600 million francs respectively. In 1962 the United Kingdom repaid 2·25 milliard francs, while Canada made a drawing of 1 milliard francs. These operations brought the total of the item 'International Monetary Fund' to 6,739 million francs.

(*d*) *Other agreements.* This item represents the total of the Bank's claims in foreign currencies and in Belgian francs on foreign countries which are not parties to the European Monetary Agreement and with which Belgium has concluded bilateral payments agreements.

5. DEBTORS IN RESPECT OF FORWARD TRANSACTIONS IN FOREIGN EXCHANGE AND GOLD

This item consists of the equivalent in Belgian francs of the Bank's claims on buyers of forward exchange and gold; the counterpart on the liabilities side is the item 'Foreign exchange and gold payable' (No. 19).

6. COMMERCIAL BILLS

This portfolio includes, in addition to commercial bills payable in Belgium which have been discounted on behalf of semi-public credit institutions, financial institutions and individuals, discounted bills in Belgian francs which are payable abroad.

7. ADVANCES AGAINST COLLATERAL

Total of advances on current account and of short-term loans granted against the pledging of gold bullion or specified securities listed periodically in the *Moniteur*.

8. PUBLIC BILLS (Article 20 of the Statutes; Agreements of September 14, 1948, and April 15, 1952)

Under the terms of the agreements concluded between the government and the Bank on September 14, 1948, and April 15, 1952, and in accordance with Article 20 of the Statutes, the total of the portfolio held by the Bank as a result of operations carried out in conformity with paragraphs 3 and 9 of Article 11 of the Bank's organic law may not exceed 10,333 million francs, a credit line of 333 million francs having been opened to the Luxemburg Government on April 15, 1952.

(*a*) *Treasury certificates.* This item represents the short-term credit extended by the Bank to the government. The certificates in respect of these advances are non-interest-bearing up to a total of 2,465 million francs, i.e. the amount by which as at September 13, 1948, the government's indebtedness to the Bank exceeded the consolidated debt (35 milliard francs; see No. 11 below).

(*b*) *Bills issued by institutions whose liabilities are guaranteed by the government.* These are short-term bills issued by various semi-public institutions.

(*c*) *Other Belgian public bills.* This item comprises interest-bearing Treasury certificates purchased by the Bank on the market (from banks, financial institutions, etc.).

9. DIVISIONAL MONEY AND MINOR COIN

This consists of the copper, nickel and silver coin and the Treasury notes in the Bank's tills. The limit to the Bank's holdings of coin and of notes issued by the Treasury is set, in accordance with the agreements at present in force between the Minister of Finance and the Bank, at 700 million francs.

10. BALANCES AT THE POSTAL CHEQUE OFFICE

The Bank's funds at the Postal Cheque Office.

11. CONSOLIDATED CLAIM ON THE STATE (Article 3(*b*) of the law of July 28, 1948, and Article 3 of the law of June 19, 1959)

The first paragraph of the first of these texts runs as follows: '35 milliard francs of the state's debt *vis-à-vis* the National Bank shall be converted into a consolidated debt.'

Of this sum, 1 milliard francs (Article 3 of the law of June 19, 1959) has been repaid out of the state's annual share of the profits of the National Bank.

12. PUBLIC SECURITIES (Articles 18 and 21 of the Statutes)

Securities acquired up to an amount corresponding to the Bank's capital, reserves and amortization funds.

13. REAL PROPERTY, EQUIPMENT AND MOVABLES

Book value of the land and premises of the various offices of the Bank in Belgium and in the Grand Duchy of Luxemburg.

Equipment and movables, which are completely written off, are shown only as a memorandum item.

14. SECURITIES OF THE STAFF PENSIONS FUND

Public securities and current-account balances of the said fund.

15. SUNDRY ITEMS

Comprise:

accounts receivable, i.e. items to be cashed (cheques, coupons, redeemable paper, etc.), amounts receivable from third parties in respect of dealings in securities or foreign currencies, of the printing of notes and miscellaneous documents, and of postage charges and stamp duty;

miscellaneous expenses, such as charges for the shipment of gold;

budgetary expenditure, e.g. general expenses.

LIABILITIES

16. BANK-NOTES IN CIRCULATION

Total of bank-notes issued by the Bank (in denominations of 100, 500

and 1,000 francs) less those held in its tills; the item refers to the notes issued since the monetary reform (decree-law of October 6, 1944).

Article 26 of the Statutes lays down that 'the notes shall be payable at sight at the offices of the Bank in Brussels on conditions determined by the law'. However, Article 4 of the law of April 12, 1957, states that 'the Bank shall be temporarily exempted from the obligation of redeeming its notes in specie'.

17. CURRENT ACCOUNTS

A. TREASURY

(1) *Ordinary account.* Under this heading are entered the current transactions carried out on behalf of the Treasury by the Bank acting as Government Cashier. When the account shows a debit balance, the government issues Treasury certificates which increase by a corresponding amount the total of the asset item 'Public bills: (*a*) Treasury certificates' (No. 8a); the balance shown represents the amount that remains due to the Treasury after these operations.

(2) *Special anti-cyclical tax* (law of March 12, 1957). Reserve fund provided for by the said law.

(3) *Special E.P.U. liquidation account.* See under 'Assets' the note to item 4, 'International agreements (law of July 28, 1948): (*a*) European Payments Union'.

B. FOREIGN BANKS: ORDINARY ACCOUNTS

Liabilities, in Belgian francs, *vis-à-vis* foreign banks resulting from operations other than those provided for by payments agreements. This item also includes the Belgian franc account of the International Monetary Fund (168·75 million francs), corresponding to the minimum balance in Belgian francs that the Fund must hold in its current account at the Bank.

C. MISCELLANEOUS CURRENT ACCOUNTS

This item comprises the deposits at the National Bank of banks established in Belgium, of institutions subject to special legal provisions and of public authorities, deposits of private individuals and amounts payable.

18. INTERNATIONAL AGREEMENTS (law of July 28, 1948)

(*a*) *European Monetary Agreement.* The amount entered under this

heading consists of liabilities towards member countries of the E.M.A. resulting from the operations carried out within the framework of the European Monetary Agreement.

(*b*) *Other agreements.* Balances in Belgian francs in favour of foreign countries resulting from the execution of payments agreements between the Belgium–Luxemburg Economic Union and the countries concerned.

TOTAL SIGHT LIABILITIES

It should be noted that this total includes not only bank-notes in circulation and current accounts but also foreign liabilities arising out of international agreements; these sight liabilities are contracted, therefore, towards both residents and non-residents.

19. FOREIGN EXCHANGE AND GOLD PAYABLE

This is the counterpart of the asset items 'Foreign exchange and gold receivable' and 'Debtors in respect of forward transactions in foreign exchange and gold' (Nos. 3 and 5).

The difference between the totals for these items is accounted for by liabilities in spot foreign exchange received on behalf of third parties and by exchange rate differences.

20. STAFF PENSIONS FUND

This item is the counterpart of the asset item 'Securities of the Staff Pensions Fund' (see No. 14).

21. SUNDRY ITEMS

Comprise:

gross earnings (budgetary expenditure is included in 'Sundry items' on the assets side);
miscellaneous contingency and reserve accounts;
suspense items in respect of liabilities.

22. CAPITAL

The capital amounts to 400 million francs, of which 200 million francs is owned by the state. This latter sum was subscribed by the Bank's surrendering to the state the profits it made during the war.

23. RESERVES AND AMORTIZATION ACCOUNTS

This item includes the statutory reserve (Article 5 of the law of July 28, 1948, and Article 14 of the Statutes), the extraordinary reserve and the amortization account in respect of the Bank's real property, equipment and movables.

DEUTSCHE BUNDESBANK

I

ORIGINS AND LEGAL FRAMEWORK

FOUNDATION

On June 21, 1948, the Deutsche Mark replaced the Reichsmark as the currency unit in the western occupation zones of Germany (the present German Federal Republic), and a few days later in the western sectors of Berlin.[1]

Closely bound up with this currency reform was the complete reorganization of the central-banking system. In each of the western German Länder a legally autonomous Landeszentralbank was established,[2] which carried out central-banking business at a regional level. Upon this regional sub-structure was erected the Bank deutscher Länder as apex of the banking system and lender of last resort. This bank possessed the exclusive right of note issue and it alone was responsible for carrying out the common monetary and credit policy. The body determining the policy of the Bank deutscher Länder was the Board of Directors (Zentralbankrat). This consisted of the Presidents of the Landeszentralbanken, the President of the Board of Directors, who was elected by the latter and who, as *primus inter pares*, acted as chairman, and the President of the Board of Managers of the Bank deutscher Länder, who was also elected by the Presidents of the Landeszentralbanken and who was at the same time the head of the administration of the Bank deutscher Länder.

In 1957 a new law was passed concerning the constitution of the central bank,[3] which abolished the decentralized two-tier structure and established in its stead a unitary bank—the Deutsche Bundesbank.

This was done (*a*) by merging the Landeszentralbanken (which had

[1] A peculiar mixed currency system existed in the western sectors of Berlin until March 20, 1949; in addition to the western Deutsche Mark, the eastern Deutsche Mark—which was put into circulation in the Soviet occupation zone as the result of a separate currency reform—also passed as legal tender.

[2] For details and special features of the west German central-banking system, see the article by Willi Schmidt and Kurt Andreas entitled 'Bank deutscher Länder und die angeschlossenen Landeszentralbanken' in the Enzyklopädisches Lexikon für das Geld-, Bank- und Börsenwesen, Vol. 1, Frankfurt am Main, 1957.

[3] Law concerning the Deutsche Bundesbank of July 26, 1957 (*Federal Law Gazette*, I, of July 30, 1957, page 745).

previously been legally independent entities) and the Berliner Zentralbank with the Bank deutscher Länder, and (*b*) by transforming the Bank deutscher Länder and the Landeszentralbanken incorporated therein into the Deutsche Bundesbank.

CAPITAL RESOURCES AND UTILIZATION OF PROFITS

The original capital of the Deutsche Bundesbank is DM 290 million; the Bank's capital is owned by the Federal Republic.

The net profit of the Bundesbank is applied in accordance with a scheme of distribution established in the Law concerning the Deutsche Bundesbank,[1] as follows:

(*a*) to build up the Bundesbank's reserves: 20 per cent of the net profit, or DM 20 million, whichever is the greater, has to be transferred to a legal reserve until the latter amounts to 5 per cent of the note circulation; the legal reserve may only be used to offset depreciation and to cover other losses; after the allocation to the legal reserve, payments out of the net profit are first to be made in respect of the dividends allotted to the former shareholders of the Reichsbank by the Law concerning the Liquidation of the Deutsche Reichsbank and the Deutsche Golddiskontbank—6 per cent of the nominal value of the profit-sharing certificates (*Genussscheine*) issued to the shareholders of the Reichsbank in place of their share certificates.[2] When this has been done, 10 per cent of the remaining profit may be used to constitute other (free) reserves, the total amount of which must not exceed the amount of the Bundesbank's basic capital;

(*b*) to supply a special fund for the purchase of equalization claims;[3] DM 40 million, or DM 30 million from the business

[1] See Article 27.

[2] See Article 5 of the Law concerning the Liquidation of the Deutsche Reichsbank and the Deutsche Golddiskontbank of August 2, 1961 (*Federal Law Gazette*, I, of August 8, 1961, page 1165).

[3] Equalization claims are interest-bearing (usually 3 per cent) Debt Register claims on the public authorities—the Länder or the Federation—which were issued to the banks and insurance companies, including the Bank deutscher Länder and the Landeszentralbanken, at the time of the currency reform as a compensatory payment in respect of their Reichsmark liabilities which were converted into Deutsche Mark and in order to provide them with appropriate capital resources. Only the amount which could not be covered by other assets was compensated (the so-called deficient cover). The equalization claims held by the central-banking system, now the Bundesbank, are not redeemable until further notice; the Law on the Redemption of Equalization Claims provides for the redemption of equalization claims held by the credit institutions and insurance companies in accordance with a set programme. In certain circum-

year 1980 onwards, has to be transferred to a fund constituted under the Law on the Redemption of Equalization Claims for the purpose of purchasing equalization claims held by banks and insurance companies;[1]

(*c*) the remaining balance has to be transferred to the Federation; from 1960 onwards the residual profits due to the Federation are passed, up to the sum of DM 10 million, to a special fund, out of which the Deutsche Bundesbank has to redeem profit-sharing certificates issued to the shareholders of the Reichsbank.[2]

SEAT OF THE BANK

In principle, the Bundesbank has its seat at the seat of the Federal Government. So long as this is not in Berlin, however, the seat of the Bank is in Frankfurt am Main, which had already developed into an important financial and banking centre in the Federal Republic following the foundation of the Bank deutscher Länder.

LEGAL STRUCTURE AND RELATIONS WITH THE FEDERAL GOVERNMENT

The Deutsche Bundesbank is a legal person under public law. It does not come under government supervision; the organs of management of the Deutsche Bundesbank are on a par with the highest Federal authorities and are not subject to instructions from the Federal Government or, of course, to instructions from any other authority. The Bank should not, however, be regarded as forming a fourth power in addition to the executive, legislative and judiciary powers within the meaning of the public-law theory of the division of powers. The nearest one can get to the peculiar legal position of the Bundesbank is to see it as a special part of the executive entrusted,

stances purchases of equalization claims held by the credit institutions and insurance companies can be made over and above the amounts envisaged in the programme out of the resources of a fund specially set up for this purpose (i.e. from the point of view of the creditor institution they can be redeemed).

[1] The Law on the Redemption of Equalization Claims of June 14, 1956, was declared by the Federal Constitutional Court to be unconstitutional for reasons that have nothing to do with the formation of the fund. It will thus be necessary to pass a new law acceptable to the Federal Constitutional Court. In the meantime there is an agreement between the Bundesbank and the Federal Government whereby the Bundesbank is to proceed as it has done in the past, i.e. to make allocations to the fund from its profits and apply these resources in the manner prescribed by the Law.

[2] See Article 7 of the Law concerning the Liquidation of the Deutsche Reichsbank and the Deutsche Golddiskontbank and also, in the Annex to this chapter, the note to asset item 13(b).

as an autonomous body, with the responsibility for monetary and credit policy as its own particular function.

It is true that the Bundesbank is bound by the Law itself to support the general economic policy of the Federal Government, but only in so far as this is consistent with its duty of safeguarding the currency. This clause is not to be interpreted as meaning that the central bank's policy must be subordinated to general economic policy and is no more than a component of that policy without an independent function of its own. The passage is rather to be construed as a general call for co-operation. In its policy the Bank may not take a completely independent line or heed only its own views. Nor may its measures conflict with the basic tenor of general economic policy. It should rather endeavour to discharge its function while at the same time observing the broad lines of economic policy laid down by the government. In the event of conflict the Bank could, however, take its stand on the precedence of the function assigned to it in the Law. The Law makes no provision for the event of a prolonged conflict and serious differences between the government and the Bank. On this point the legislature took the view that a situation of this kind, which, to judge by experience, was likely to be most unusual, could not be resolved by water-tight legal prescription but only by the common sense of the parties concerned, directed towards the economic interests of the country.

Of especial importance for the collaboration between the Federal Government and the Bundesbank are a number of provisions which enjoin on both parties co-operation and mutual consultation. The Bundesbank thereby assumes the position of an impartial and independent adviser. Thus the Bundesbank is bound to advise the Federal Government on matters of primary importance in the field of monetary policy and, upon request, to furnish it with information.[1] This should not be regarded simply as a duty of the Bank but also as an important right. The question of mutual consultation is dealt with in the provisions which lay down that

(*a*) members of the Federal Government are entitled to take part in the deliberations of the Central Bank Council, and
(*b*) the Federal Government is to invite the President of the Bundesbank to participate in its deliberations on matters of importance in the field of monetary policy.

If members of the Federal Government take part in meetings of the

[1] In addition, the Federal Minister for Economic Affairs and the Federal Minister of Finance have the right to receive a copy of the auditor's report and the report of the Federal Audit Office on the annual statement.

Central Bank Council, they may bring motions but they have no vote. At their request the taking of a decision must be deferred, but not for more than two weeks. After this period has elapsed, the Central Bank Council is free to take a decision by voting in the normal way. The purpose of this provision is thus probably only to allow, in the event of initially divergent views, sufficient time for agreement to be reached on the point at issue. A disadvantage of the provision is that it is possible even for a change in the discount rate to hang in the balance on account of an objection on the part of the government, with the result that the impact of such a measure may be weakened by speculative counter-operations.

The other powers of the Federal Government are set forth in the Law. Their essential purpose is to provide the rudimentary elements for a general supervision by the state. The powers of the Federal Government do not encroach upon the autonomy of the Bank in the field of monetary policy. The powers in question are as follows:

(*a*) approval of participation by the Bundesbank in international institutions (Article 4 of the Bundesbank Law);
(*b*) participation in the appointment of members of the Directorate and approval of the contracts governing the appointments of all members of the organs of management (Articles 7 and 8 of the Bundesbank Law);
(*c*) approval of the issue of notes of small denominations (Article 14 of the Bundesbank Law); this right rests on a basis of reciprocity, since the Bundesbank for its part enjoys certain rights in the matter of the minting of coin, which is a sovereign right of the Federation;
(*d*) approval of the By-laws, of the Staff Regulations and of the regulations relating to the careers of officials of the Bank (Articles 31 and 34 of the Bundesbank Law);
(*e*) co-operation in the issue of money-market paper to be created expressly for purposes of open-market policy (Article 42 of the Bundesbank Law).

The Federal Administration may derive no powers or rights from its control over the assets of the Bundesbank, apart from its right to residual profits[1] and any claim it may have to the proceeds of liquidation (in the event of the liquidation of the Bundesbank). The influence on policy and the conduct of business that normally goes with control of the capital of an enterprise is absent in the case of the Bundesbank, owing to the special provisions relating to its autonomy in the Bundesbank Law.

[1] See the section 'Capital resources and utilization of profits', pages 55–56.

II

FUNCTIONS AND OBJECTIVES

In the Law concerning the Bundesbank the Bank's functions are formulated in deliberately general terms:[1]

> 'the Bundesbank, making use of the powers in the field of monetary policy conferred upon it under this Law, shall regulate the money circulation and the supply of credit to the economy with the aim of safeguarding the currency and shall ensure the due execution by banks of payments within the country as well as to and from foreign countries'.

The wording of this passage makes it clear, in the first place, that the Deutsche Mark is a managed currency. The currency unit is not tied to a metallic or any other standard;[2] moreover, the Law concerning the Bundesbank does not lay down any fixed external value (exchange rate) for the Deutsche Mark. The exchange value of the Deutsche Mark is based on international agreements and has been officially reported to the International Monetary Fund as the par value. The par value, first designated in the period of rudimentary foreign trade relations after the Second World War as the 'rate of exchange of the Reichsmark (after June 21, 1948, the Deutsche Mark) against the dollar', was provisionally set by the Allied military governments of the western occupation zones on May 1, 1948, at \$0·30 = RM/DM 1. Following the devaluation of the pound sterling by 30·5 per cent on September 19, 1949, the rate of exchange for the Deutsche Mark was fixed with effect from the same date at \$0·238 = DM 1, which represented a devaluation of 20·6 per cent.[3] This rate was declared as the par value by the German Federal Republic when it became a member of the International Monetary Fund in 1952. On March 6, 1961, the parity of the Deutsche Mark against the dollar (and correspondingly against all other currencies fixed in relation to the dollar) was adjusted by the Federal Government and established at \$0·25 = DM 1.[4] This adjustment represented a revaluation of the Deutsche Mark by 5 per cent. It should be emphasized in this connection that the German

[1] See Article 3 of the Law concerning the Bundesbank.

[2] The currency unit of the German Reich, the Reichsmark, was defined in terms of gold, even though there were never any gold coins in circulation and the Reichsbank's obligation to convert the Reichsmark into gold had been suspended. The Deutsche Mark, on the other hand, is an independent creation of the currency laws.

[3] Since the dollar, calculated at the official gold price, represents 0·888 grammes of fine gold, DM 1 was equal to 0·2116 grammes of fine gold.

[4] i.e. DM 1 = 0·2222 grammes of fine gold.

Federal Republic is not bound either by the Law concerning the Bundesbank or by any other law to adhere to any specific monetary system. Whether the Federal Republic shall have a system of currency convertibility (with fixed or flexible exchange rates) or a system of exchange control (possibly with multiple rates) is not, therefore, prescribed by law but is decided on purely monetary grounds by the competent authorities.

The words 'the Bundesbank shall regulate the money circulation and the supply of credit to the economy' place the whole of the monetary field within the realm of central-bank policy. Its activity is, therefore, not merely limited to putting into circulation, on the basis of its note-issuing privilege, the notes required (as legal tender) for payments transactions; its function as central bank is, rather, the far wider one of regulating the whole of the economy's money supply (including credit institutions' deposit liabilities) and of influencing the banks' credit-granting in accordance with the current requirements of monetary and financial policy.

The Law prescribes that the aim of the Bundesbank's monetary policy shall be 'to safeguard the currency'. This concept is without any doubt to be taken as covering both the internal and the external aspects of stability. The legislature did not deem it expedient to determine at the outset any individual goal or stabilization standard to be aimed at by the Bundesbank.

In addition to its supreme monetary responsibility, the Bundesbank has a further important technical function: it is required by the Law to ensure the due execution by banks of payments within the country as well as to and from foreign countries. It is thus its duty to provide the necessary arrangements and services for the carrying-out of cashless money transfers and, if need be, to take corrective measures should the smooth running and efficiency of the system be impaired. In other words, therefore, the Bank is also responsible for the technical efficiency of the monetary system.

III

STRUCTURE AND ADMINISTRATION

EXTERNAL STRUCTURE

THE REGIONAL MAIN OFFICES: LANDESZENTRALBANKEN

Under the new constitution of the Bundesbank the Landeszentralbanken have become legally dependent Main Offices. Nevertheless, they have retained their organizational independence. This is mainly seen in the fact that the Landeszentralbanken conduct on their own responsibility all transactions and administrative business within

the area for which they are competent. Thus, more particularly, the following business is reserved to the Landeszentralbanken: transactions with the Land and with public administrations and transactions with credit institutions within their area of competence, except transactions with credit institutions which have central functions for the whole of the Federal territory. They are subject, in the conduct of business and in administration, to the decisions taken by the Central Bank Council in matters of credit and monetary policy and to the general directives issued by the Central Bank Council, which may be supplemented in individual cases—if special circumstances should warrant it—by particular instructions. Even in the case of decisions, instructions and measures of the central authority that are generally binding on the whole system the principle of decentralization is indirectly safeguarded by the fact that the Landeszentralbanken participate through their Presidents in the formulation of policy by the Central Bank Council.[1]

THE HEAD OFFICE

Transactions that do not fall within the competence of a Landeszentralbank but, by their very nature, have to be handled by a central agency are dealt with by the Head Office of the Bundesbank, which, to all intents and purposes, has taken over the functions and business set-up of the Bank deutscher Länder. The Head Office of the Bundesbank in Frankfurt am Main is not a central administration in the sense that the regional Main Offices are responsible to it but is—apart from a few border-line cases—the office that deals with transactions and administrative business that have to be handled by a central agency, more particularly transactions with the Federal Administration and its Special Funds, transactions with credit institutions which have central functions for the whole of the Federal territory, foreign exchange transactions and other transactions with foreign countries, and open-market operations.

THE BRANCH ESTABLISHMENTS: MAIN BRANCHES AND BRANCHES

The Bundesbank maintains a network of branch establishments, thus continuing an old tradition in the history of Germany's note-issuing banks; even the early '*Zettelbanken*', which existed prior to the setting-up of the Reichsbank, had numerous branches, and the Reichsbank systematically extended the network of branches in accordance with local business needs. The network of the Bundesbank's branch establishments is organized on a two-tier basis, a distinction being made between Main Branches (*Hauptstellen*) and Branches (*Zweigstellen*). The Main Branches are situated in the larger

[1] See page 63.

towns or in centres of considerable economic importance and are directly responsible to the Landeszentralbank. The Branches (i.e. subsidiary branches), on the other hand, are attached to and responsible to the Main Branches. The branch establishments enable banks whose business covers only a limited area (these include, apart from 'regional' and 'local' banks, a considerable number of private banks and the—largely decentralized—savings banks and credit co-operatives) to enter into direct business relations with the Bundesbank. The local branches of big banks, too, can establish direct contact with the Bundesbank through its branch network, thus avoiding involved transactions through their own head offices. Further, the Bundesbank's network of branches enables the banks' minimum reserves to be held on a decentralized basis, an arrangement which gives the minimum reserve system mobility and elasticity. A particularly important function of the Bundesbank's network of branches is to make its services available for the execution of payments. This greatly facilitates both cash payments and the execution of cashless money transfers. The branch establishments also assist in the execution by banks of payments to and from foreign countries. In view of its special position as the bankers' bank, the Bundesbank engages in no direct credit transactions with business enterprises (that is, with non-banks), in complete contrast to the Reichsbank, which sometimes competed in the bill-discounting business with the deposit banks. As a result of this change in the position of the central bank the network of branch establishments has lost its formerly important function of transacting direct business with non-banks.

Places in which the Bundesbank has a branch establishment are 'bank places' (*Bankplätze*), a term that is of practical significance, since (*a*) the minimum reserve ratios are graded according to 'bank places' and 'non-bank places' (preferential treatment being given to the latter), and (*b*) only bills payable at 'bank places' can be discounted. In addition, a 'bank place', being a place in which the Bundesbank has a branch establishment, is a place where the Bundesbank's services are available for the execution of payments.

ORGANS OF MANAGEMENT AND ADVISORY BOARDS

THE ORGANS OF MANAGEMENT: CENTRAL BANK COUNCIL, DIRECTORATE AND BOARDS OF MANAGEMENT OF THE LANDESZENTRALBANKEN

The supreme organ of management of the Bundesbank is the Central Bank Council. This body determines the policy of the Bank. The Directorate and the eleven Boards of Management of the Landeszentralbanken are the implementing and administrative bodies, i.e. the executive organs.

As the supreme organ of management, the Central Bank Council determines the monetary and credit policies of the Bank and lays down general directives for the conduct of business and administration. It may even, in individual cases, issue instructions to the Directorate and to the Boards of Management of the Landeszentralbanken, and in cases of doubt it may delimit the responsibilities of these bodies. The primary function of the Central Bank Council is the formulation of the monetary and credit policy of the Bank; its other powers enable it to achieve the necessary co-ordination in the conduct of business and in administration.

The central executive organ is the Directorate, parallel to which are the Boards of Management of the Landeszentralbanken, which are the regional executive organs. The Directorate manages the business of the Bank as a whole and conducts its administration, except in matters coming within the competence of the Boards of Management of the Landeszentralbanken.[1] It follows that, since the Boards of Management of the Landeszentralbanken are competent to conduct regional transactions and administrative business within the areas concerned, the Directorate is responsible for the conduct of business and the administration of the Head Office of the Bundesbank.

No less important than its function of conducting the business that has to be handled centrally by the Bundesbank is the Directorate's responsibility for the implementation of the decisions taken by the Central Bank Council. By the inherent nature of the latter function, the Directorate is also largely responsible for the preparatory work leading up to these decisions. The fact that the Directorate can take the initiative in this way naturally means that it often has a decisive influence on the decision-making itself. Thus, the Directorate *de facto* assumes, by virtue of the intrinsic importance of its functions, a position of special prominence.

The Central Bank Council is composed of:

the President and the Vice-President of the Deutsche Bundesbank (who are also the presiding officers of the Directorate)

the other members of the Directorate and

the Presidents of the Landeszentralbanken (who also preside over the Boards of Management of the Landeszentralbanken).

The Directorate consists of the President and the Vice-President of the Bundesbank and up to eight further members (the number appointed so far is seven). All the members of the Directorate must possess special professional qualifications.

The Board of Management of each Landeszentralbank consists of the President and the Vice-President of the bank concerned and—in

[1] See Article 7 of the Law concerning the Deutsche Bundesbank.

so far as the By-laws permit—of one or two additional members. The By-laws, which were issued after the Law concerning the Bundesbank on November 27, 1958, provide for three members of the Boards of Management in the case of the larger Landeszentralbanken, i.e. those in Baden-Württemberg, Bavaria and North Rhine-Westphalia. Like the members of the Directorate, all the members of the Boards of Management must possess appropriate professional qualifications.

In principle, all the organs of the Bundesbank are intended to act as boards. In the case of the Boards of Management of the Landeszentralbanken, however, the board principle can only be put into practice if they consist of at least three members, as in Baden-Württemberg, Bavaria and North Rhine-Westphalia. If the Board of Management consists only of the President and the Vice-President, as in the other Landeszentralbanken, the President has the decisive voice. The presidential principle that thus asserts itself in the majority of the Landeszentralbanken is certainly at variance with the form of organization envisaged in the Law. This dualism in the organizational structure of the Boards of Management of the Landeszentralbanken exists because the Federal Government objected to a provision in the By-laws intended to establish the board principle as a general rule for the Boards of Management of all Landeszentralbanken.

THE ADVISORY BOARDS AT THE LANDESZENTRALBANKEN AS CONSULTATIVE BODIES

At each Landeszentralbank an Advisory Board is set up, which consults with the President of the Landeszentralbank on questions of monetary and credit policy, and with the Board of Management on the execution of the tasks incumbent upon the latter within its area. Through the Advisory Boards the Bundesbank keeps in constant touch both with the credit institutions and with those who borrow from them. Each Advisory Board consists of up to ten members, all of whom must be specially conversant with credit matters. Not more than half of the members are to be chosen from the various branches of the credit business, and the others from industry, commerce and agriculture and from among wage and salary-earners. The appropriate Land Ministers (or Senators) are also afforded the opportunity of attending meetings of the Advisory Boards.

APPOINTMENT OF MEMBERS OF THE VARIOUS ORGANS AND OF THE ADVISORY BOARDS

The President and the Vice-President of the Bundesbank, as well as the other members of the Directorate, are appointed by the President

of the Federal Republic on the proposal of the Federal Government. In this regard, therefore, the Federal Government has a substantial and decisive influence; it is thus in a strong, though not dominant, position in the matter of appointments. As regards the other members of the Central Bank Council, namely the Presidents of the Landeszentralbanken—who, like the members of the Directorate, are members by virtue of the Law—the appointments are made by the President of the Federal Republic on the proposal of the Bundesrat. In making its proposals the Bundesrat is restricted to the recommendations of the authorities competent under Land legislation, i.e., as a rule, the Land Government.[1] The Bundesrat is not, therefore, empowered to make a proposal of its own and cannot act on its own initiative. It has, at most, the right to reject a proposal made by the Land Government; in such an—exceptional—event no name would be put forward until the Bundesrat and the Land in question had agreed on a candidate. The participation of the Länder in the nomination procedure reflects the incorporation into the Bundesbank constitution of federal elements taken over from the two-tier decentralized system. The Law expressly aims at maintaining the influence of the appropriate Land Governments in the appointment of the Presidents of the Landeszentralbanken. The two authorities entitled to propose nominees—the Federal Government and the Bundesrat—are obliged in each case to consult the Central Bank Council. The Central Bank Council's right to be consulted with regard to the selection of those who are to be appointed to it is derived from the former, more far-reaching autonomy of the Board of Directors of the Bank deutscher Länder in making appointments.[2] The Bundesbank has unlimited autonomy in this respect only in the case of the appointment of the Vice-Presidents of the Landeszentralbanken and of any other members of the Boards of Management; these are appointed by the President of the Bundesbank on the proposal of the Central Bank Council. There are no direct appointments to the Central Bank Council, because the Council is, *ex lege*, composed of specific members of the other organs.

The period of office of members of the various organs of the Bundesbank is normally eight years; in exceptional cases appointments may be made for shorter periods, although not for less than two years. The members of the Advisory Boards are appointed (for

[1] The Bundesrat was brought into the procedure for constitutional reasons; since the Bundesbank is a Federal institution based on a Federal law, only Federal organs can exert official powers in relation to it.

[2] The Board of Directors of the Bank deutscher Länder itself elected by co-optation the President of the Board of Directors and the President of the Board of Managers, i.e. the two chief officers in the dual structure of that time; it also nominated—autonomously—the other members of the Board of Managers.

a period of three years) by the President of the Bundesbank on the proposal of the respective Land Government after consulting the Board of Management of the Landeszentralbank.

IV

POWERS, ACTIVITIES AND MONETARY POLICY

NOTE-ISSUING PRIVILEGE

The Deutsche Bundesbank has the exclusive right to issue notes in the Federal Republic and its notes are the sole unrestricted legal tender. The minting of divisional coin is one of the sovereign rights of the Federation.[1] The Coinage Law and the note-issuing privilege of the Deutsche Bundesbank are interrelated inasmuch as notes for amounts of less than DM 10 may only be issued in agreement with the Federal Government, whereas coins may not be issued for amounts of over DM 5. The obligation to accept Federal coin is limited (to a total of DM 20 in the case of coins expressed in Deutsche Mark and a total of DM 5 in the case of those expressed in Pfennig). For the striking of Federal coin in excess of the per capita amount of DM 20 the consent of the Central Bank Council is required. Federal coins are put into circulation by the Bundesbank. If coin is struck in excess of the per capita amount of DM 20, the Bundesbank's own holdings (whether derived from its original supply of coin or from coin returned to the Bank) may not for any length of time exceed 15 per cent of the total amount of coin in circulation. Any amounts in excess of this are taken into special custody by the Bank on behalf of the Federal Administration. These provisions make it impossible for the Federal Administration to force coin on the public (or the Bank) and thus to drive out bank-notes.

CENTRAL-BANKING OPERATIONS AND THE SHAPING OF MONETARY POLICY

DISCOUNT AND INTEREST RATE POLICY

The Bundesbank Law expressly authorizes the Bank to fix independently the rates of interest for its rediscounting and similar business with banks and its advances to public authorities. The rate at which the Bundesbank is prepared to discount (i.e. rediscount) for banks

[1] See the Law on the Striking of Divisional Coin of July 8, 1950, as amended by the law of January 18, 1963; from June 21, 1948—the date of the entry into force of the currency reform—until July 8, 1950, the coinage prerogative belonged to the Bank deutscher Länder.

bills which satisfy certain eligibility requirements is the discount rate. The rate at which the Bundesbank grants banks advances against security (*Lombardkredite*) is the 'lombard' rate. The latter stands by convention at a fixed level (one percentage point) above the discount rate; the rate at which the Bank grants cash advances to public authorities authorized to engage in credit transactions is normally identical with the discount rate. In special circumstances the Bundesbank could depart from the normal rule in fixing the lombard rate and the interest rate for cash advances.

Interest rates on the German money market—which is fundamentally an interbank market—are free-market rates. Despite this, the Bundesbank exercises an influence on the formation of interest rates on the money market in two different ways: (*a*) its discount rate constitutes a decisive market factor in the determination of the level of money-market rates, since these are never formed autonomously, independently of the central bank's discount rate;[1] (*b*) in addition to this means of setting a basic reference point for the money-market rates from without, as it were, by means of its discount rate, the Bundesbank is able by way of open-market operations to influence the liquidity position, and hence the formation of interest rates, in accordance with its overall monetary policy. Thus it may operate in the market either as buyer or seller as the prevailing situation requires. The discount rate, therefore, is not merely an instrument for influencing the Bundesbank's banking operations (rediscounting and similar business with the banks and credit-granting to public authorities); discount policy extends far beyond the confines of the central bank's own banking business. In conjunction with open-market operations, it enables the Bundesbank to exercise a substantial influence on the money market.

The discount rate is not only the rate independently set by the Bank for its own operations and a decisive factor in the money market; it is also an important guide-line for the influencing by administrative means of the banks' interest rates, i.e. the rates charged by the banks on credits and paid on deposits. The Law on the Credit System[2] gives the Federal Minister for Economic Affairs

[1] If interest rates on the money market should at any time diverge substantially (either upwards or downwards) from the discount rate, this would represent an abnormal situation which, sooner or later, would entail either adjustment on the part of the market or confirmation of the market situation by discount policy.

[2] See Article 23 of the Law on the Credit System of July 10, 1961 (*Federal Law Gazette*, I, of July 15, 1961, page 881), which supersedes the outmoded law of the same name passed in 1934. The Law on the Credit System is not a law pertaining solely to organization or one establishing economic controls but is a general regulating code for the credit system: among other things this law regulates the form and extent of government supervision over the banking system.

the power to issue, in consultation with the Bundesbank, statutory orders setting limits to the range of interest rates and commissions applied by the banks. This legal authority may be transferred to the Federal Supervisory Office; in such a case, however, the latter may issue orders only in agreement with the Bundesbank. The wording 'limits to interest rates' excludes the absolute fixing of rates by administrative order; it permits only the laying-down of maximum rates that may be undercut by the banks and/or minimum rates that may be exceeded. Administrative interest rate policy is usually confined to the fixing of maximum rates; this principle had already emerged in practice before the Law on the Credit System of July 10, 1961, was passed. Even before the (new) law came into force the rates charged by the credit institutions for discounts and current-account advances were linked to the Bundesbank's lombard rate.[1] Interest rates granted on deposits were also based on the official discount rate. The Law on the Credit System expressly lays down that any orders in respect of interest rates shall reinforce the measures of the Deutsche Bundesbank in the field of credit policy. This administrative support strengthens the effectiveness of discount policy, irrespective of whether the market forces which it touches off or which are already in operation are tending in the same direction.

Finally, in the German credit system changes in the discount rate affect the development of interest rates on the capital market. There is, of course, no direct link between the discount rate and the capital-market rate. The changes in the capital-market rate that follow changes in the discount rate are to be regarded rather as induced effects. The discount rate itself does not affect the capital market, but the general liquidity situation of the banks and the economy, which the discount rate reflects or which the Bundesbank has created by means of its discount policy and its other controls, is a decisive factor in the development of the capital market, together with other factors such as liquidity preference or general interest rate expectations.

REDISCOUNTING AND SIMILAR BUSINESS AS THE SPECIFIC FIELD OF APPLICATION OF THE BUNDESBANK'S AUTONOMOUS INTEREST RATE POLICY

The specific field of application of the Bundesbank's autonomous interest rate and discount policy is its rediscounting and similar business (*Refinanzierungsgeschäft*). The term '*Refinanzierung*', in the present context, covers only (*a*) the Bundesbank's rediscounting

[1] The lombard rate generally stands one percentage point above the discount rate.

operations, (*b*) its advances against certain types of security and (*c*) the purchase by it—only, however, under certain conditions—of equalization claims. The usual form taken by Bundesbank assistance (*Refinanzierung*) is the rediscounting of bills; by comparison, the granting of advances against security and the purchasing of equalization claims play a minor—even incidental—rôle.

The Bundesbank's rediscounting and other credit facilities are open only to banks.[1] In extending assistance to the banking system, the Bundesbank deals directly with the banks—a procedure that is facilitated by its network of branches. In its rediscounting operations the Bundesbank purchases from the banks good commercial bills, by which term the Law means such bills as (*a*) are backed by three parties known to be solvent, (*b*) are payable within three months and (*c*) were drawn to finance transactions in merchandise.

Advances against security are in principle granted by the Bundesbank only for the purpose of easing, for a short period, unforeseen and temporary strains in a bank's liquidity position, or, exceptionally, when a bank has exhausted the rediscount quota to which it is entitled.

A special kind of Bundesbank assistance is the purchase of equalization claims. Credit institutions (and insurance companies) which are forced to sell equalization claims in order to fulfil their obligations can sell their claims to a Purchase Fund, the resources of which are derived principally from an allocation of part of the profits of the Bundesbank. In so far and so long as the resources of the Fund are not sufficient for this purpose, the Bundesbank may advance funds by purchasing equalization claims for its own account. The equalization claims temporarily acquired by the Bundesbank in this way are resold to the Fund as soon as it again has sufficient funds at its disposal.[2]

Apart from the qualitative requirements that bills of exchange must satisfy to be eligible for rediscounting and the strict selection of the collateral for the granting of loans, the Bundesbank may make its assistance subject to general conditions. Thus it can, by means of its General Business Conditions, lay down rules for the 'good conduct' of the banks in their operations. These rules may apply, for example, to the structure of business, the soundness of credits granted or the precautionary provision of liquid resources. The General Business Conditions do not represent directives issued by a

[1] This restriction does not apply to the Bank's operations on the liabilities side: the Bundesbank is allowed to accept (non-interest-bearing) deposits from any source.

[2] The purchasing of equalization claims is included here for convenience as one of the forms taken by Bundesbank assistance, despite the fact that the interest rate is not a factor in such transactions.

supreme authority that are binding on all credit institutions; rather are they requirements that have to be met only by such credit institutions as need to have recourse to Bundesbank assistance. As even the banks that have no indebtedness to the central bank must allow for the possibility of being compelled at some time or other by the force of unforeseeable circumstances to seek its assistance, all banks regard the Bundesbank's General Business Conditions in practice as a binding standard.

In addition to the powers afforded by the General Business Conditions, the credit institutions are subject to the general regulating principles of the Law on the Credit System. This requires them to have adequate capital resources and to maintain an adequate degree of liquidity.[1] Non-observance of these basic requirements may lead to the application of sanctions by the Federal Supervisory Office, which could consist in the prohibition of dividend payments or further credit-granting and the refusal of rediscount and similar facilities at the Bundesbank. Although the Law itself does not set up any absolute standards for adequate capital resources and liquidity, it grants the Federal Supervisory Office the power to draw up and issue, in agreement with the Bundesbank, basic ratios that have generally binding force. These basic ratios (normally known as 'guiding ratios in regard to credits' (*Kreditrichtsätze*)) are taken as the criterion in judging whether the banks' capital resources and liquidity are adequate. The drawing-up of the ratios, in which—since it must be done with the Bank's agreement—the Bundesbank plays a decisive part, constitutes an important regulating function.

Apart from the influence exerted by the rate of interest, quantitative restrictions also limit the extent to which the credit institutions have recourse to the Bundesbank. The Law expressly grants the Bundesbank the power to apply such administrative measures to supplement its discount policy.[2]

The fact that in the last fifty years credit institutions and, above all, business enterprises borrowing funds have undoubtedly become less sensitive to changes in the rate of interest, so that nowadays discount rate policy alone does not 'bite', at least not in every situation, has made it necessary for such policy to be supplemented by administrative measures. The system of 'rediscount quotas' has therefore been evolved as a means of limiting recourse to the central bank.

[1] See Articles 10 and 11 of the Law on the Credit System.

[2] Article 15 of the Bundesbank Law states: 'For the purpose of influencing the money circulation and the supply of credit, the Deutsche Bundesbank shall from time to time fix the interest and discount rates to be applied to its transactions and shall determine the principles governing its credit and open-market operations.' The words 'shall determine the principles governing its credit operations' mean that the Bundesbank may avail itself—as it is put in the 27th Annual Report of the B.I.S.—of 'ancillary' instruments.

Every credit institution eligible for rediscounting facilities at the Bundesbank is allocated a quota, which it may not exceed. In case of need a bank that has exhausted its rediscount quota must resort to the—dearer—advances against security. The latter, however, are by no means available to it in unlimited measure, but are granted only under certain conditions. The method used to calculate the size of rediscount quotas is based on the 'liable funds' of each bank; the method contains, however, sufficiently elastic elements to avoid too rigid an application of the quota system. The special positions of individual banks may, within certain limits, be taken into account in determining the quota, provided this is compatible with credit policy.

It is not only when rediscount quotas are almost or completely exhausted that they prove to be an effective instrument of central-bank policy; on the contrary, it has been found that even in periods when only a small part of the quotas is being taken up a reduction, which may not affect the banks at all as far as any immediate need for central-bank assistance is concerned, nevertheless has a restrictive influence. For reduced quotas abruptly alter the usability and suitability for purposes of recourse to the central bank of the bill holdings that form part of the banks' secondary reserves. Thus, whether they wish it or not, the banks are obliged to pursue a more cautious policy.

In quite exceptional situations the former Bank deutscher Länder, by administrative means, imposed limitations on the volume of the banks' lendings[1] or resorted to the severer variant of ordering them to reduce the volume of credit.[2] Such harsh measures, which have a number of unpalatable and inequitable aspects, are not, of course, an instrument of routine policy but a last resort, to be used by the Bundesbank only in exceptional cases and in extreme circumstances.

OPEN-MARKET POLICY AND OPEN-MARKET OPERATIONS

The Bundesbank is able to influence bank liquidity, and thus the banks' credit-granting, by means of its rediscounting and similar business when almost all banks, to a greater or lesser extent, are forced to seek assistance from the central bank. The market is then for practical purposes 'in the Bank'; in these circumstances the discount rate is the lowest rate at which the banks can obtain money. The situation is quite different when the banks, by virtue of a steady outflow of central-bank money through channels other than rediscounting, etc.,[3] are or are becoming independent in respect of liquidity and thus have no further—or only a limited—need of

[1] During the period of credit restriction in 1948.
[2] During the period of credit restriction in 1950–51.
[3] '*Refinanzierung*' in the narrower sense of the term.

assistance from the Bundesbank. This assistance is then confined to only a few banks or to the covering of an occasional marginal requirement.

When the banking system is not indebted to the central bank at all or only to a small extent, the rôle of influencing bank liquidity is taken over to a greater extent by open-market policy; then the Bundesbank is 'in the market' and regulates bank liquidity by its operations on the market. Open-market operations form an essential complement to the rediscounting and other facilities provided to the banking system. When the credit institutions are no longer so dependent on the Bundesbank for finance, open-market policy comes into play as an alternative procedure. With the change in emphasis from rediscounting and similar business to open-market operations, the discount rate shifts its position in relation to other money-market rates, so that it is now at the top; this shows that the Bundesbank is 'in the market'. Since liquidity is distributed unevenly throughout the banking system, a situation may arise in which a number of banks still have to have recourse to rediscounting at the Bundesbank while others are already independent of such assistance and have surplus funds available for investment on the money market. If in such a situation the Bundesbank offers banks with surplus funds money-market securities from its own portfolio, it can prevent (*a*) the market interest rate from falling below the official discount rate, and (*b*) the banks still indebted to the Bundesbank from meeting their liquidity requirements by means of money-market funds instead of by further recourse to rediscounting. Moreover, differences in standing and the competitive relations between the various groups of credit institutions may also hinder the balancing of supply and demand on the money market. It is mostly banks which have large amounts of public money at their disposal that offer funds on the interbank money market or purchase money-market paper offered by the Bundesbank.

The problems of open-market policy have been presented here from the typically German viewpoint. In Germany, as a matter of principle and also by tradition, rediscounting and similar operations are constitutionally a fundamental part of the central bank's business. It would, of course, also be possible entirely or partially to release the banks from their dependence on rediscounting facilities when the liquidity of the banking system is low and to replace such assistance by open-market purchases. From a quantitative point of view the result is the same whether the Bundesbank rediscounts bills or buys open-market paper. The only prerequisite would be that the banks possessed adequate portfolios of suitable securities (instead of, or in addition to, their holdings of rediscountable bills).

Under the Bundesbank Law the Bundesbank may, for the purpose

of regulating the money market, purchase and sell on the open market at market prices:[1]

(*a*) all commercial bills that are eligible for rediscounting at the Bundesbank;
(*b*) Treasury bills and Treasury bonds issued by the Federation, certain Federal Special Funds or the Länder;
(*c*) bonds and claims on the Federal Debt Register issued by the institutions named in sub-paragraph (*b*) above;
(*d*) other bonds admitted to official stock exchange dealings.

The range of possibilities embraces all maturities and both money-market and capital-market paper. Mention should be made of the express provision in the Law that the Bundesbank may undertake open-market operations only for the purpose of regulating the money market, i.e. of influencing bank liquidity, and not for such purposes as supporting the capital market or facilitating long-term financing. Of course, an open-market transaction in securities always also has an effect on the capital market, even if it is undertaken in order to regulate the money market.

In practice, the main accent of the Bundesbank's open-market operations falls on the purchase and sale of Federal Treasury bills (at up to three months) and discountable Federal Treasury bonds (at up to two years). Since the floating debt of the Federation and of the Länder is relatively small and the Bundesbank's portfolio, therefore, scarcely contains any securities for the financing thereof, the Bundesbank acquires the necessary *masse de manœuvre* by converting its equalization claims[2] on the Federation into money-market securities (known as 'mobilization paper'). In this way the Bundesbank can 'mobilize' about DM 8,500 million. The fact that this money-market paper is obtained in exchange for equalization claims is clear evidence that the Bundesbank's open-market operations always take the form of sales from or purchases for the Bank's own security portfolio. It is only such portfolio sales that have an automatically restrictive effect upon the liquidity of the banking system. In addition to these genuine open-market transactions, however, the Bundesbank in its capacity as fiscal agent issues and repurchases or redeems money-market securities and loans on behalf of the Federation, the large Special Funds and the Länder. Issues or sales made under this heading will also restrict bank liquidity if the proceeds are sterilized at the Bundesbank or used to cancel the latter's book credits.

Apart from the money-market paper procured specifically for purposes of open-market policy, the Bundesbank also purchases and

[1] See Articles 15 and 21 of the Bundesbank Law.
[2] See footnote 3 on page 55.

sells, in the interests of regulating the money market, storage agency bills, other short-term paper issued by public agencies and prime acceptances. The storage agency bills (which take the form of promissory notes) are issued to finance the holding of stocks of important basic foodstuffs. They are provided with a Federal guarantee and are secured in terms of commodities (by the assignment by bill of sale of the goods stored). Prime acceptances consist solely of bankers' acceptances serving the purpose of financing imports, exports and merchanting trade. The issuers of prime acceptances must be firms of unquestionable soundness and of an appropriate standing. The accepting bank must be 'qualified to deal in acceptances'. A certain procedure is laid down for determining which banks so qualify. In transactions in prime acceptances the Bundesbank—diverging somewhat from the principle otherwise adhered to by it of dealing directly on the market with every credit institution—deals only with the Privatdiskont-Aktiengesellschaft, which operates as a specialist institution in this sector.

The market in prime acceptances and the interbank market for storage agency bills are parts of the German money market. In these sections of the market the Bundesbank does not pursue any line that is at variance with its overall money-market policy. In practical terms the Bundesbank's dealings in prime acceptances and storage agency bills serve to adjust these sections of the market.

Mobilization paper differs from prime acceptances, storage agency bills and other money-market paper in that, by virtue of the way it is created, it derives from the portfolio of the Bundesbank; the Bundesbank thus has a *masse de manœuvre* at its disposal which it can employ directly—in its first transaction in such securities—to skim off liquidity. The opposite applies to storage agency bills, prime acceptances and other money-market paper—all of which generally serve the purpose of financing the issuer—for the placing thereof causes a simultaneous expansion in the banks' credit-granting and does not lead to any absorption of liquidity (provided, that is, that the issuer spends the funds in question and that the interval between borrowing and redisbursement is not too great). Nevertheless, in so far as the transactions concerned involve the issuing of Treasury bills or Treasury bonds by the Federal Administration, the Federal Railways or the Federal Postal Administration, they are significant from the point of view of the money market; for, if the securities could not be placed with the banks, the issuing bodies would be obliged to have recourse to cash advances from the Bundesbank or to draw on their giro balances with it; and such action would lead to a creation of liquidity.

In intervening in the activity and trend of the market, the Bundesbank itself fixes its respective selling and buying rates for the various

money-market securities (there is, thus, no tender, as there is in a number of other countries). The buying rate, i.e. the rate at which the Bank takes up securities from the market, is as a rule $\frac{1}{8}$ to $\frac{1}{4}$ per cent higher than the selling rates. The difference between the buying rate and the selling rate may, in special circumstances, be widened if the Bundesbank is reluctant to take up certain classes of securities offered on the market. Although the Bundesbank has not entered into any legal commitment to repurchase before maturity the mobilization paper which it has sold to the market or to take up storage agency bills and prime acceptances circulating on the market, it does so in practice in order to give its open-market policy the necessary flexibility and the character of a two-way operation. The Bundesbank enters the market on both the supply and the demand side and guides it to the position desired by means of the respective rates of interest at which it sells or buys.

In principle, the Bundesbank sells money-market securities only to banks and certain public agencies and also buys securities only from this group of institutions. This limitation on its operations dates back to a decision of the Central Bank Council taken in 1952.[1] The credit institutions for their part sell money-market paper to non-bank customers, in accordance with a still valid agreement[2] dating from before the war, only on terms which, compared with the prevailing interest rate on deposits, are not very attractive. The object of this agreement was to protect the deposits of the credit institutions. Private non-bank customers were to be discouraged from direct investment by the relatively unfavourable terms offered to purchasers of money-market securities and persuaded instead to deposit their funds with banks. The abstention of the Bundesbank, though it was not itself bound by this interbank agreement, is connected with this arrangement. When the decision of the Central Bank Council was taken, the central bank—at that time the Bank deutscher Länder—wished to avoid offering any competitive investment facilities for non-bank funds; nothing was to be done that might have prejudiced the formation of deposits at the credit institutions, which at that time —shortly after the currency reform—they urgently needed.

By virtue of this development the organization of the German money market has acquired an exclusive character as a market for banks and certain qualified public agencies. Large amounts of private capital and private institutional investors do, however, penetrate the money market via banks affiliated to particular companies. This special character of the German money market means that in the

[1] Decision of March 5 and 6, 1952.

[2] See Article 5, paragraphs 3 and 4, of the Agreement on Creditor Interest Rates of December 22, 1936, as modified by the amendments of April 23, 1940, June 12, 1940, May 8, 1941, and May 29, 1943.

main only bank liquidity falls within the scope of the Bundesbank's open-market operations. These do not affect the liquidity position of the rest of the economy (business enterprises and individuals), as they would if the group of institutions operating in the market were extended to include private parties other than banks. The Bundesbank voluntarily and purposely forgoes the possibility of also being able to acquire liquid funds from parties other than banks by way of open-market operations.

MINIMUM RESERVE POLICY

Minimum reserve policy may be regarded as the special prerogative of the Bundesbank; it is the instrument *par excellence* for controlling liquidity. By means of minimum reserve policy the Bundesbank exercises what one might term an 'overall' influence on the credit potential of the credit institutions, although, as will be shown later, it does not do so in such a way that an 'overall surplus' of reserves arises, forcing the banks to expand their lending activity, or that surplus reserves are absorbed, so that, to take a border-line case, even a shortage of reserves might occur, obliging the banks to restrict their credit-granting.

Under the Law the Bundesbank may require the credit institutions to maintain with it as—non-interest-bearing—balances on giro account, minimum reserves equal to a specified percentage of their liabilities. The minimum reserve ratios are graded as follows:

(*a*) according to the type and term of the liabilities (sight liabilities, time liabilities or savings deposits);
(*b*) according to the size of the institution (institutions being at present divided into four reserve categories);
(*c*) according to the origin of the funds (liabilities *vis-à-vis* residents or non-residents);[1]
(*d*) according to 'bank places' (i.e. places at which there is a branch establishment of the Bundesbank) and 'other places' (where there is no branch).

The Bundesbank may also apply higher ratios to any increase in the banks' liabilities compared with the position at a certain date. The ratios fixed by the Bundesbank may not exceed 30 per cent for sight liabilities, 20 per cent for time liabilities, and 10 per cent for savings deposits. Within these limits the Bundesbank may fix ratios at various levels in accordance with general principles such as those given above or others. The weapon of minimum reserve policy cannot be wielded against particular banks as a penal measure.

[1] Since February 1, 1962, the rates for liabilities *vis-à-vis* residents and non-residents have been the same.

The Law expressly lays down that minimum reserves are to be held exclusively in the form of balances on giro account, i.e. as deposits at the Bundesbank. Banks have, therefore, no alternative way of fulfilling the reserve requirement, such as investment in specific interest-bearing paper which could be counted towards the minimum reserves. Nor does the Law allow interest to be paid on deposits maintained in fulfilment of the reserve requirement, because there is a general clause prohibiting the Bundesbank from paying interest on giro deposits.

If reserve requirements are raised the credit institutions have to find means of increasing their balances at the Bundesbank, whereas if they are reduced balances which were formerly immobilized[1] are released and can be put to use. Practical experience has shown that it cannot be assumed that surplus reserves[2] already in existence will be immobilized if the minimum reserve ratios are raised; and, conversely, when reserve requirements are relaxed, surplus reserves are in practice never formed, even though they can, of course, be shown statistically to be the result of the measures adopted. Even when there is a persistent marked increase in the banking system's liquidity, no surplus reserves are formed, other things being equal, because, in the flexible German banking system, the growth in liquidity is not reflected in a surplus of cash (primary reserves) but is immediately invested in some form of secondary reserves. Among the forms which such investment may take are the depositing of funds with foreign banks or their employment on foreign money markets and the purchasing of domestic money-market paper; moreover, if the banks are still indebted to the central bank a general increase in liquidity is reflected in a reduction in such indebtedness. In this case, too, the banks' secondary reserve position is strengthened through an increase in their rediscountable bill portfolios.

Thus, if the Bundesbank raises its reserve requirements, the banks have to acquire the necessary cash largely at the expense of their secondary reserves. They may, however, during a short transitional period after the increase add current accruals of

[1] In the German minimum reserve system the immobilization of balances in the form of compulsory reserves does not mean that these cannot be used. Banks may make free use of their balances on any day (e.g. to honour bills, make payments, settle deficits in their daily clearing transactions or obtain notes to meet an excess of out-payments over in-payments). In so doing they may let their minimum reserves fall temporarily below the requirements, as long as they ensure that these are met on a monthly average basis. Shortfalls must therefore be compensated by corresponding surpluses in the course of the month.

[2] In so far as surplus reserves of a purely statistical nature are to be found, these are due to unavoidable errors in the banks' planning and occur only within very narrow margins.

liquid resources derived, for instance, from receipts (not repatriations) of foreign exchange to their compulsory reserves until the requirement has been met, and thus to that extent avoid encroaching upon their secondary reserves. As investment practice varies from bank to bank and as liquidity is unevenly distributed over the banking system, the banks naturally react differently. In order to procure the necessary cash they will either liquidate some of their foreign currency investments abroad, sell domestic money-market paper or increase their indebtedness *vis-à-vis* the Bundesbank. However the individual banks react, their secondary liquidity always suffers. This decrease in secondary liquidity makes them less willing and able to grant credits; conversely, an improvement in this secondary reserve position tends to cause an increase in their credit-granting. In so far as the banks are compelled by the minimum reserve requirements to have increased recourse to Bundesbank assistance, or to have recourse to it again after a break, the general position of the central bank as the 'lender of last resort' is also strengthened.

In its objectives and in the effect which it has on credit, minimum reserve policy in many respects resembles open-market policy. Minimum reserve policy and open-market policy cannot, however, be said to be instruments of the same type or the same value which can be substituted for each other at will. Although they both aim at influencing liquidity (by immobilizing or freeing the banks' cash), a fundamental difference is to be seen in the way in which they do this: the administrative immobilization of liquid resources by means of minimum reserve policy is irrevocable as far as the banks are concerned; it cannot be reversed by a decision of the banks themselves. In the case of open-market policy the situation is quite different. The tying-up of cash in open-market paper represents merely a shift from primary liquidity to secondary liquidity and is, therefore, a step which can be gone back upon, although the terms may be less favourable than before.

A further difference, which likewise shows minimum reserve policy to be more severe and inflexible, lies in the fact that minimum reserve policy in its present form has an overall effect and does not take into consideration the liquidity position of individual credit institutions, whereas open-market operations as a means of influencing liquidity are selective and discriminating in the way they work and are used to even out differences in liquidity. Reducing this contrast to a simple formula, minimum reserve policy, as a restrictive measure, might be described as the placing by the Bundesbank with the banks of a compulsory, non-interest-bearing loan with no fixed currency period, whereas the placing of open-market paper may be regarded as a commercial mobilizable money-market credit granted by the banks to the Bundesbank at market rates.

As the very nature of minimum reserve policy suggests, a typical situation calling for its application is that in which it is necessary to make overall structural adjustments in the whole liquidity position of the banking system or in which, from the general monetary point of view, an adjustment is needed in view of structural changes in bank liquidity which have come about over a fairly long period without any intervention on the part of the central bank. In these conditions minimum reserve policy takes over from open-market policy, which by its nature is the appropriate instrument for regulating the short end of the market. Open-market policy needs to be 'relieved' periodically in this way because, in the circumstances prevailing in Germany, the Bundesbank's *masse de manœuvre* is too small to enable it to cope with persistent structural alterations in bank liquidity.

At times, too, the relationship between these two instruments may be reversed. Open-market operations can, if the *masse de manœuvre* is sufficiently large, be substituted for an increase in minimum reserves, when this would otherwise have been called for. This happens, for instance, when the Bundesbank, after making very heavy use of the minimum reserve instrument, wishes to go some way towards meeting the banks' desire to receive interest on the funds to be immobilized.

THE POSITION OF THE BUNDESBANK IN TRANSACTIONS WITH PUBLIC AUTHORITIES

The Bundesbank is not only the bankers' bank; it also has important special functions to perform in direct transactions with public authorities:

(*a*) it may, within strictly defined limits, grant credits to certain public authorities (the Federation, the Länder and the large Federal Special Funds—the Federal Railways, the Federal Postal Administration, the E.R.P. Special Fund and the Equalization of Burdens Fund);
(*b*) it holds the cash balances of certain public authorities;
(*c*) it performs the general services of a fiscal agent.

The movement of public funds from the Bundesbank to the credit institutions or, conversely, from the credit institutions to the Bundesbank invariably causes fluctuations in the banking system's liquidity position. A special situation arises when public authorities—for the most part the Federal Administration—make payments to foreign countries; payments abroad made from the public authorities' balances at the Bundesbank have no effect on liquidity. Changes in the cash position of the public sector do not, therefore, necessarily

indicate the effect on liquidity produced by the movement of public funds. It can—and in fact often does—happen that, although the cash account of the public authorities shows a deficit, the so-called internally effective transactions, taken on their own, are actually withdrawing liquid resources from the banking system.

As the credit-granting of the central bank to the public authorities could form a dangerous source of inflation, the Bundesbank Law contains particularly stringent and restrictive provisions regarding this part of its business. In the Law itself maximum amounts ('credit ceilings') are laid down, up to which the Bundesbank may grant short-term credits to specially privileged public administrations (the Federation, the Länder and the large Federal Special Funds, i.e. the Federal Railways, the Federal Postal Administration, the E.R.P. Special Fund and the Equalization of Burdens Fund).[1] Treasury bills which the Bundesbank has purchased for its own account or to the purchase of which it has committed itself (by an undertaking to rediscount them) are counted towards the credit ceiling of a public administration. In this connection it is to be noted that the 'mobilization Treasury bills' (*Mobilisierungsschatzwechsel*) are, owing to their totally different origin and function, not counted towards the credit ceilings. In aggregate, the credit ceilings allocated to the public administrations come to about DM 8·5 milliard. This figure includes special earmarked amounts totalling DM 3·5 milliard, which are solely for the use of the Federal Administration in meeting its commitments deriving from its participation in or membership of international or supranational organizations. The extent to which such special credits affect the internal economy depends on the use to which the DM allocations in question are put in the countries concerned.

The privileged public administrations do not have a right to credit up to the full amount of their respective ceilings. The purpose of having ceilings is to set an upper limit to the Bundesbank's lendings. The Bundesbank is not obliged, but only authorized, to grant credit up to this outside limit. It is thus able to take its decisions in the light of its overriding responsibilities in the field of monetary policy.

As a logical counterpart to the credit facilities opened to privileged public administrations, the latter are legally bound to deposit their liquid resources at the Bundesbank (the so-called 'deposit obligation').[2] Any other deposit or investment of funds requires the approval of the Bundesbank. In deciding how far the depositing of

[1] See Article 20 of the Bundesbank Law.

[2] Of the public administrations eligible for credit facilities at the Bundesbank, the Federal Railways and the Federal Postal Administration are, in view of their special situation, not subject to the deposit obligation; these two Special Funds have other close links with the Bundesbank. The Bundesbank exerts a powerful *de facto* influence on the investment policy and monetary arrangements of the Railways and the Postal Administration.

funds elsewhere is to be approved, the Bundesbank is, however, required by the Law to give due consideration to the interest that the Länder have in maintaining their (regionally active) State and Land banks. This clause is intended to protect the business relations that have grown up in the course of time between individual Länder and their State and Land banks, the foundation of which dates back in many cases far into the past.

The provisions relating to the deposit obligation and, in conjunction therewith, the power of the central bank to permit exceptions to these rules, are put together under the heading 'Directive governing deposits' in the list of the Bundesbank's powers in the field of monetary policy. It is true that the concentration of public funds at the Bundesbank and the partial renunciation of its power so to concentrate funds provide a means of influencing bank liquidity. This manipulation of the flow of public moneys may complement the other instruments of liquidity control. The actual prevailing situation is, however, by no means always such as to permit the Bundesbank to use 'deposit policy' to support its overall liquidity policy. The general cash position of the public authorities and their special interests in the matter of investment, which of necessity call for the granting of exceptions, by no means necessarily coincide with the central bank's aims with regard to liquidity. Movements of public funds may, by reason of timing, volume and direction, produce fluctuations in the banks' liquidity position which are at variance with the requirements and objectives of liquidity and credit policy. At times the Bundesbank has to make adjustments by intervening with its other measures of liquidity control. Deposit policy can therefore be regarded only conditionally and within limits as a supplementary instrument for influencing liquidity.

The Law takes into account the position of the Bundesbank as fiscal agent by requiring the privileged group of public administrations to issue marketable securities principally (i.e. not exclusively) via the Bundesbank.[1] If a public administration wishes to depart from this ruling, the issue has to be effected in consultation with the Bundesbank. In the case of issue through other channels the Bundesbank thus has no power of veto. In fact, of course, its view carries weight, even if it is not decisive.

In the field of the public authorities' security-issuing policy it has become the accepted practice for the Federal Administration and the Federal Special Funds to place their issues with the assistance of the Bundesbank, which acts as leader of the syndicate; the Länder, on the other hand, as a rule use their State and Land banks, but first

[1] It should be explained that in Germany there is no control of capital issues from the viewpoint of economic priorities either by government authorities or by the Bundesbank.

consult the Bundesbank concerning the projected new issues. When acting as leader of a syndicate the Bundesbank does not itself take up a quota, nor does it apply any measures for its own account to support prices. Any intervention on the part of the Bundesbank is undertaken for account of the issuers, in whose interest it is that the market should be regulated to a certain extent. Such intervention for account of others is not aimed at influencing and shaping the market but is confined to evening out transitory or incidental fluctuations.

FOREIGN EXCHANGE POLICY AND FOREIGN EXCHANGE TRANSACTIONS

The Bundesbank administers the economy's central foreign exchange reserves. In Germany there is no special exchange equalization fund separate from the Bank whose operations cushion the impact of fluctuations in the foreign exchange reserves on the domestic flow of money. Every addition to the Bundesbank's foreign exchange reserves automatically creates domestic currency and, conversely, every reduction in the reserves leads to a flow of domestic currency back to the Bundesbank.

In contrast to the Bundesbank's rediscounting and similar business, its open-market operations and its direct dealings with public authorities, all of which can be regarded as spheres of business in which the Bank is largely its own master and which can be influenced by specific instruments of control, its foreign exchange business reflects more or less automatically the trend in the balance of payments, which cannot as such be directly influenced by the central bank.[1] The small exchange spreads laid down in international agreements leave only limited scope for an independent exchange rate policy on the part of the Bundesbank; it has to intervene or allow intervention by other central banks at the extreme intervention points fixed. Sometimes the Bundesbank will intervene even before the intervention points are reached if it recognizes that the fluctuation in the market is only temporary and would produce only a temporary movement in the rate of exchange.

In law the Bundesbank is authorized to conduct any kind of foreign exchange transaction; it may purchase and sell media of payment expressed in foreign currency, including bills of exchange and cheques, claims and securities, as well as gold, silver and platinum, and also transact any other banking business with foreign

[1] From an all-embracing and long-term point of view, the basic attitude of the central bank in its credit policy does, of course, determine the balance-of-payments trend (together with other exogenous factors); from the short-term point of view, however, individual measures of the central bank will not greatly affect the balance of payments.

countries.[1] In foreign business its powers are thus wider than they are in the domestic sector. The only restrictions on the Bundesbank's foreign exchange business are those arising out of the Federation's international agreements with the International Monetary Fund and the European Economic Community, together with those arising out of the European Monetary Agreement.

As a subsidiary instrument of foreign exchange policy, the Bundesbank has developed—on the basis of its wide powers in the field of foreign exchange business—the practice of swap operations (which are undertaken only with banks). The object of swap operations is to counteract the concentration of foreign exchange at the Bundesbank and to encourage instead foreign currency investment by individual banks on a decentralized basis. Such an incentive to invest funds with foreign banks or on foreign money markets is created spontaneously when there is a sufficiently large interest rate differential between the domestic and foreign markets (in this regard, of course, only the interest rates at the main foreign financial centres are relevant). If this incentive, when account has been taken of the premiums to be paid by the banks for forward cover, is too small or even non-existent,[2] the interest rate differential can be artificially widened, or one created, by swap operations. A swap operation consists of two separate transactions: a spot purchase (or sale) of foreign exchange—in practice only dollars—and a forward sale (or purchase). An essential feature of the transactions is that the spot and forward deals are concluded for the same amount and between the same parties. If in the case of a spot sale the Bundesbank charges a smaller premium for the conclusion of the counterpart forward transaction than that quoted on the free foreign exchange market, investment abroad, which would not otherwise take place, is thereby stimulated. If, by applying the same exchange rate for both the spot and forward parts of the swap, the Bundesbank charges no premium at all, the interest rate differential will be the sole factor determining the action taken by the banks. In this case the banks receive what amounts to a subsidy equal to the cost of forward cover, so that they can take full advantage of the interest rate differential.

Finally, the Bundesbank can in its swap operations even go so far as to pay a premium; in that case a so-called 'premium rate' arises, which means that the Bundesbank's forward rate for dollars is more favourable than the rate it quotes for spot transactions. In this way it can widen an insufficient interest margin so that overall there is

[1] See Article 19, paragraph 1, items 8 and 9 of the Bundesbank Law.

[2] The profitability of foreign investment may diminish either because interest rate differentials shrink or because, although the differentials remain unchanged, the cost of forward cover on the market becomes so high that it absorbs the interest margin.

again an incentive for foreign currency investment abroad. The conversion of a negative interest margin into a positive one by granting a sufficiently large premium—this would be the extreme case—could, however, only occur as an exceptional measure, because, although the forward rate may go beyond the intervention points (which apply only to the spot rates), it cannot under normal market conditions diverge from them to an unlimited extent.

Swap operations can of course be applied in the reverse direction. They are then an auxiliary means of strengthening the central foreign exchange reserves at the expense of the credit institutions' direct investments in foreign currencies.

Swap operations are concluded not only between the Bundesbank and German credit institutions but also between central banks: if both parties are central banks, swaps have the character of short-term bilateral interim credits between two countries (e.g. to tide over a temporary shortage of a certain currency).

OTHER FUNCTIONS

PARTICIPATION IN THE OFFICIAL SUPERVISION OF THE BANKS

Among the administrative powers granted to the Bundesbank, not by the Law concerning the Bundesbank but by the Law on the Credit System, are its power to influence the interest rates charged by the banks on credits and paid by them on deposits[1] and its right to co-operate in drawing up and administering the basic ratios on the basis of which the Federal Supervisory Office assesses whether the necessary conditions for any banking operation—adequate capital resources and liquidity—are fulfilled.[2]

In addition, the Bundesbank plays a part in the general supervision of the banks exercised by the Federal Supervisory Office for the Credit System. The current observation of the conduct and the trend of each individual bank's business is left to the Landeszentralbanken, as the Bundesbank's regional establishments, on account of their banking experience, their close contacts both with the banks and with the business community and the comprehensive range of information available to them. The Landeszentralbanken evaluate for their purposes the monthly balance sheets, the annual statements of account and annual reports, the statutory reports of the auditors and other appropriate data and thus acquire a reliable

[1] As this power forms a corollary to discount policy, it has been described in that context (see pages 66–68).

[2] The significance of this regulating principle for the policy of the Bundesbank is described on page 70.

picture of the solvency and stability of the banking system. The supervision extends also to the banks' larger commitments, which are examined in the light of their soundness and justifiability from a banking point of view. The Law on the Credit System lays down that the Bundesbank must be notified of any credits that exceed a certain level (the so-called *Grosskredite* (credits to a single borrower that exceed in aggregate 15 per cent of the credit institution's capital and published reserves) and *Millionenkredite* (credits exceeding DM 1 million)); the Bundesbank, for its part, apprises the Federal Supervisory Office of its views regarding '*Grosskredite*' and informs the credit institutions which have notified it of '*Millionenkredite*' if the borrowers are multiple debtors. Official action in the field of bank supervision (such as the issue of orders, prohibitions or directives and the imposition of penalties) is a matter for the state authorities.

The close co-operation obtaining in the nature of things between the Supervisory Authority and the Bundesbank is promoted and increased by the express statutory provision to the effect that the Bundesbank and the Federal Supervisory Office are to inform each other of any facts or findings that may be of value for the carrying-out of their respective functions.

It must be particularly emphasized that the purpose of the supervision over the banks is not the control of credit-granting in the economy as a whole; its aim is rather to keep a check on individual banks' business activity, above all for the protection of their creditors and in order to avoid adverse consequences for the economy as a whole; the object of such supervision is to ensure the preservation of an orderly state of affairs in the credit system—what may be described as 'sound banking'. This in no way absolves the banks from responsibility for their own transactions; on the contrary, the fact that the banks are supervised emphasizes their special responsibility and liability as managers of the nation's assets; their freedom of action is not affected as long as their banking transactions are conducted in an orderly fashion.

COLLECTION OF STATISTICS

For the purpose of discharging its functions the Bundesbank is authorized to instruct all credit institutions to prepare statistics on banking and monetary matters for collection by the Bundesbank. The power bestowed on the Bundesbank by this clause of the Law is by no means of secondary importance. It enables the Bundesbank to ascertain all the facts relevant to central-bank policy.

The Bundesbank may publish the statistical results for general purposes, and it does so regularly in its Monthly Reports and

Annual Reports. It may not publish individual data or otherwise transmit such data to others. The Bundesbank's obligation to maintain secrecy regarding individual data obtained from statistics is complementary to its general duty of secrecy in banking matters. The communication of the results of the monthly balance-sheet statistics to the Bank Supervisory Authority is governed by a special clause.

The Bundesbank is only entitled to collect statistics from credit institutions; it is not empowered to do so from public administrations. If the Bundesbank wants to do this, it has to rely on a spirit of co-operation or on its right as lender or fiscal agent to make inquiries. In addition, it has pointers to the financial position of the public administrations in its (internal) business statistics.

POWERS IN THE FIELD OF EXCHANGE CONTROL

The Bundesbank's foreign exchange policy in the narrower sense of the term[1]—which is taken here to mean purely banking operations and intervention by the Bank on the foreign exchange markets—may be accompanied by administrative measures to control foreign payments and other foreign exchange transactions (i.e. exchange control). Up to August 31, 1961, the Deutsche Bundesbank (originally the Bank deutscher Länder) had sovereign powers in the field of exchange control. The exchange control regulations in force until that time were based on laws and authorizations issued by the Allied governments. The legislation enacted by the Allies rested on the prohibition principle, i.e. all foreign exchange transactions (such as the holding by residents of assets abroad, the holding by foreigners of assets in Germany, the free utilization of exchange proceeds from foreign trade, and other transactions in foreign exchange assets) were forbidden unless they were expressly approved (either generally by general licences or by specific permits).

The division of responsibility was such that the central bank was entrusted in particular with the regulation of short and long-term capital transfers to and from foreign countries, while the Federal Minister for Economic Affairs was responsible for regulating foreign trade in goods and services. In practice, however, the main exchange control regulations in all fields were the result of mutual agreement between the Bundesbank on the one hand and the Federal Minister for Economic Affairs on the other. The development from the system of complete exchange control to full convertibility, i.e. the progressive relaxation of controls, would not have been possible but for this constant co-ordination of measures. From the point of view of exchange control convertibility meant the replacement of

[1] See page 82.

the prohibition principle by a system of comprehensive general licences.[1]

On September 1, 1961, a Law on Foreign Trade and Payments,[2] passed by the legislative authorities of the Federal Republic, came into force, replacing the foreign exchange legislation of the Allied governments. This Law takes account of the complete change in the external position of the Federal Republic and lays down the principle that trade in goods and services, capital transfers, and payment and other transactions with foreign countries are basically free, as also are transactions in foreign securities between residents. Restrictions and prohibitions are now possible only in a few cases laid down in the Law or by way of statutory decrees issued by the Federal Government. Such decrees may, however, only be issued when definite conditions specified in the Law are fulfilled.

In the Law on Foreign Trade and Payments the Bundesbank is assigned the task of co-operating in the issue of statutory decrees governing capital transfers and payment transactions and transactions in foreign securities and gold; in these cases the statutory decrees are to be issued in agreement with the Bundesbank. In so far as decrees governing capital transfers and payment transactions prescribe licences for certain dealings or operations, the Bundesbank is responsible for granting them. In the case of imports subject to quota, the competent authorities (the Federal Minister for Economic Affairs and the Federal Minister of Food, Agriculture and Forests) are also to consult the Bundesbank when drawing up directives; the Bundesbank thus has the opportunity to express its views on the exchange control aspects of import schemes.

In addition, the Law grants the Bundesbank the right to obtain information over a wide field.

MONETARY AND CREDIT POLICY IN ITS PRACTICAL APPLICATION

'For the purpose of regulating the money circulation and the supply of credit'—these words recur frequently in the text of the Law—the Bundesbank has been granted all the powers that 'in the

[1] In fact exchange controls had already been so much relaxed by 1956 that the Deutsche Mark can be said to have been convertible in practice from that time on; it has been officially convertible since January 1, 1959 (the date of the liquidation of the E.P.U. and the change-over to the E.M.A.). The introduction of exchange control in Germany dates back to the time of the Reichsmark (1931); even earlier—before 1924—exchange controls were imposed from time to time.

[2] Enacted on April 28, 1961 (*Federal Law Gazette*, I, of May 5, 1961, page 482).

light of modern monetary theory and practice are appropriate and necessary for controlling the money supply'.[1] The art of all central-bank policy lies in the choice of the right means, the right time and the right balance.

As the persistent foreign exchange surpluses gradually increased the liquidity of the banking system, the credit institutions' dependence on assistance from the central bank steadily decreased. As a consequence, open-market operations acquired a significance as an instrument of liquidity control that they had never previously possessed in German central banking. In the different alternating phases of the trade cycle, open-market policy proved to be a flexible instrument both for pursuing a policy of easy money and for bringing about a tightening of liquidity. In the phase of tighter liquidity open-market policy was, of course, supported—unintentionally rather than otherwise—by fiscal policy; the temporary formation of cash surpluses, and the fact that they were concentrated in accounts held with the central-banking system, was often an advantage to the Bundesbank in its liquidity policy. There is no reason to assume that a coincidence of this kind will necessarily always obtain.

Germany does not have a large public debt; its floating debt, in particular, is small. Consequently, cash surpluses in the public sector lead to the accumulation of government balances at the central bank and thus to a corresponding decrease in bank liquidity; with a large public debt the same situation would of course lead to debt redemption. The fact that the Federal Republic has hardly any public debt requiring management explains why the Bundesbank does not, and in fact cannot, assume the function of debt management. The Bundesbank's open-market operations cannot be described as debt management. It is true that the Bundesbank deals in Treasury bills and Treasury bonds, but its transactions are confined purely to purchases for and sales from the Bundesbank's portfolio; they do not affect the size, term and other conditions of the original public debt (the Bundesbank's 'equalization claim').

Minimum reserve policy has proved effective in widely differing situations:

(*a*) In the early years after the currency reform it was applied in order to strengthen the central bank's hold over the banks that were becoming independent of recourse to central-bank assistance and thus to postpone the time when they should be partially or totally released from such dependence. In this phase, which was still characterized by a low level of bank liquidity, minimum reserve policy was used to back up rediscount policy.

[1] So runs the wording of the preamble to the government draft of a law concerning the Deutsche Bundesbank.

(*b*) As the banking system subsequently became more liquid, minimum reserve policy was used to relieve the burden on open-market policy in view of its limited *masse de manœuvre* and to increase its effectiveness. It was found that, if the reserve ratios were sharply raised, the banks' dependence on rediscounting and similar facilities, which had almost ceased, was re-established even though the banking system as a whole was in a very liquid state. The reason for this is that liquidity is distributed unevenly over the banking system. The general application of the minimum reserve instrument thus compels a number of less favourably placed banks to have earlier recourse to central-bank assistance than would otherwise be necessary. In addition, even liquid banks may be induced to acquire the extra reserves by having recourse to the Bundesbank, because they wish for certain reasons to retain for the moment their foreign currency investments or their open-market paper.

With the change-over to convertibility and as a consequence of Germany's participation in a free and open international payments system, the Bundesbank necessarily lost some of its freedom of action as far as interest rate policy is concerned. It can no longer base this policy purely on the needs of the domestic economy; when deciding upon its measures, it must also take account of the foreign trade and payments position and the international monetary situation. Interest rate policy thus has a decidedly dual character. The problem stands out particularly clearly if—as happened in 1955–56 and 1959–60—a strong upward trend in the internal economy does not lead, as the textbooks say it should, to strains in the balance of payments but—quite uncharacteristically—is accompanied by persistent balance-of-payments surpluses. In such circumstances, when the needs of the domestic economy conflict with the action called for by the foreign trade and payments situation, monetary policy becomes, in the true sense of the phrase, the art of the possible.

ANNEX

DEUTSCHE

WEEKLY

as at December 31,

Assets		In thousands of DM
1. Gold		14,490,079
2. Balances at foreign banks and money-market investments abroad		10,929,121
3. Foreign notes and coin, foreign bills and cheques		329,090
4. German divisional coin		44,776
5. Balances on postal cheque account		545,790
6. Domestic bills of exchange		1,967,383
7. Treasury bills and discountable Treasury bonds:		
(*a*) Federal Administration and Federal Special Funds	—	
(*b*) Lander	—	
		—
8. Advances against security		157,713
9. Cash advances to		
(*a*) Federal Administration and Federal Special Funds	739,100	
(*b*) Länder	—	
(*c*) other public authorities	—	
		739,100
10. Securities		1,368,969
11. Equalization claims and non-interest-bearing debt certificate		
(*a*) equalization claims from conversion of own balance sheet	8,131,377	
(*b*) equalization claims purchased	48,054	
	8,179,431	
Less equalization claims returned in exchange for money-market paper	3,768,745	
	4,410,686	
(*c*) debt certificate	547,168	
		4,957,854
12. Credits to Federal Administration for participation in international institutions		2,155,692
13. Claims on Federal Administration		
(*a*) in respect of acquisition of claims resulting from post-war economic aid	2,512,792	
(*b*) in respect of alteration of exchange parity	1,190,186	
		3,702,978
14. Credits to international institutions and consolidation loans		2,289,387
among which—		
(*a*) to I.B.R.D.	1,342,480	
(*b*) from liquidation of E.P.U.	897,079	
15. Other assets		252,711
Total		43,930,643

BUNDESBANK

RETURN

1962

Liabilities			In thousands of DM
16. Bank-notes in circulation			24,146,592
17. Deposits of			
(*a*) credit institutions (including postal cheque and postal savings bank offices)		12,232,304	
(*b*) public depositors			
(i) Federal Administration	40,607		
(ii) Federal Special Funds	634,721		
(iii) Länder	3,553,694		
(iv) other public depositors	55,229		
		4,284,251	
(*c*) other domestic depositors		278,732	
			16,795,287
18. Liabilities in respect of foreign business			
(*a*) deposits of foreign depositors		353,423	
(*b*) others		20,960	
			374,383
among which— provision of cover for letters of credit and guarantees by			
foreigners	347		
residents	6,635		
19. Amounts placed to reserve for specific liabilities			949,732
20. Capital			290,000
21. Reserves			638,000
22. Other liabilities			736,649
Total			43,930,643

EXPLANATORY NOTE ON THE WEEKLY RETURN

ASSETS

1–3. GOLD, BALANCES AT FOREIGN BANKS AND MONEY-MARKET INVESTMENTS ABROAD, FOREIGN NOTES AND COIN, FOREIGN BILLS AND CHEQUES

At the time of the introduction of the Deutsche Mark the Bank deutscher Länder, as the central bank was then called, had no gold and foreign exchange reserves of its own. For necessary payments to foreign countries—mainly for imports, the volume of which was strictly limited—its *masse de manœuvre* consisted of borrowed foreign exchange provided by the Allied military governments; in addition, the Bank deutscher Länder drew heavily upon bilateral credit lines and later upon its credit quota with the E.P.U. The whole of the gold and foreign exchange holdings shown today in the Bundesbank's return is thus the result of inflows of foreign exchange which have developed since the currency reform, i.e. from about 1951 onwards.

The gold stock originated mainly from the E.P.U. settlements. Debtor countries in the E.P.U. could opt between gold and dollars for the settlement of that part of their deficits which according to the E.P.U. rules had to be discharged in cash. As the price of gold on the London market remained for a fairly prolonged period below the official gold price ($35 per ounce) while for settlements within the E.P.U. the official rate was applied, many debtor countries elected to pay in gold. The German Federal Republic, which from about 1951 onwards had consistent payments surpluses in its transactions with other E.P.U. countries, was the beneficiary of a substantial proportion of such payments in gold. In addition to the gold reserves that accrued to the Bank deutscher Länder and the Deutsche Bundesbank from the E.P.U. settlements, the Bank deutscher Länder and the Deutsche Bundesbank have regularly effected purchases of gold with their foreign exchange earnings.

The item 'Balances at foreign banks and money-market investments abroad' contains only claims in convertible currency, i.e. foreign currency assets that can be freely used at any time; the foreign notes and coin, foreign bills and cheques shown in the Bundesbank's portfolio amount to only a relatively insignificant sum and for practical purposes may be regarded as a transitory item.

4. GERMAN DIVISIONAL COIN

This item relates to coin expressed in Deutsche Mark which has been taken over from the mints run under the control of the Federal Minister of Finance or has flowed back out of circulation.[1]

5. BALANCES ON POSTAL CHEQUE ACCOUNT

For the settlement of payments the Bundesbank holds a balance on postal cheque account, just as, conversely, the postal cheque office has to have a giro balance at the Bundesbank as a means of effecting transactions.

6 AND 8. DOMESTIC BILLS OF EXCHANGE AND ADVANCES AGAINST SECURITY

These two items show approximately how much cash the Bundesbank has made available by rediscounting bills and granting loans against security. To find the exact amount of central-bank assistance, its holdings of foreign bills purchased from German banks, which are included in Item 3, would have to be added to these two items.

7. TREASURY BILLS AND DISCOUNTABLE TREASURY BONDS

This item covers only those Treasury bills and discountable Treasury bonds which have been issued by the Federal Administration, the Federal Special Funds and the Länder for the purpose of raising funds and are held in the Bundesbank's portfolio (not to be confused with the Treasury bills and discountable Treasury bonds issued for the purpose of open-market policy).

9. CASH ADVANCES

These are book credits extended within the limits of the so-called credit ceilings to the public administrations which are eligible for credit facilities at the Bundesbank.

10. SECURITIES

The portfolio of (fixed-interest-bearing) securities is small; it is of no significance as regards open-market policy.

[1] See page 66.

11. EQUALIZATION CLAIMS AND NON-INTEREST-BEARING DEBT CERTIFICATE

The equalization claims resulting from the conversion of the Bank's own balance sheet—shown in a preliminary column—reflect the supply of cash made available by an act of government (i.e. not by way of normal central-bank operations) within the framework of the currency reform (initial allocation of cash to the public authorities, to trade and industry and to all private individuals, in the form either of bank-notes or of a giro-account credit at the central bank, and the liquidity allocation to the credit institutions). The item 'Non-interest-bearing debt certificate' refers to a special form of equalization claim deriving from the currency conversion in Berlin. The amount represented by purchases of equalization claims is small; essentially it represents a residual item in respect of the assistance which the then Berlin Central Bank—now merged with the Bundesbank—had to extend to the Berlin credit institutions for the improvement of their liquidity in the early years after the currency reform.

The equalization claims converted into 'mobilization paper' for the purpose of open-market policy are also shown separately in the preliminary column. Thus, only the current net holding of equalization claims is given in the main column of the return. No holdings of mobilization paper for the Bundesbank's own account are shown in its return; mobilization paper that comes back to the Bank is automatically reconverted into equalization claims. The net amount of equalization claims held shows the size of the *masse de manœuvre* still available to the Bundesbank for open-market operations.

12. CREDITS TO FEDERAL ADMINISTRATION FOR PARTICIPATION IN INTERNATIONAL INSTITUTIONS

This item shows the Bundesbank's earmarked credits to the Federal Administration for participation in international institutions. The maximum amount is fixed by the imposition of a ceiling.

13. CLAIMS ON FEDERAL ADMINISTRATION

(*a*) *In respect of acquisition of claims resulting from post-war economic aid.* In 1961 the Bundesbank made available to the Federal Administration about DM 3·1 milliard (in foreign exchange) for the advance repayment of the claims of the United Kingdom, France and the United States. In effect, the Bank thereby acquired those claims. The Federal Administration is to discharge its liabilities—under slightly modified terms—by payments to the Bundesbank (up to

1968). Changes in the redemption arrangements can be made by mutual agreement, a provision designed mainly to allow for advance repayment; so far one non-contractual payment has been made.

(*b*) *In respect of alteration of exchange parity.* The alteration of the par value of the Deutsche Mark (viz. the revaluation) on March 6, 1961, gave rise to a loss of about DM 1,475 million in the Bank's assets expressed in foreign currencies. To offset part of this loss, DM 210 million was drawn from the reserves; the remainder is covered by a Federal acknowledgement of indebtedness. The debt bears no interest; it will be repaid by the allocation of at least those amounts that would be due to the Federal Administration as its share of the Bundesbank's profits from the financial year 1961 onwards. Non-contractual payments are also possible in respect of this item.

14. CREDITS TO INTERNATIONAL INSTITUTIONS AND CONSOLIDATION LOANS

This item consists mainly of fairly long-term loans granted to the I.B.R.D. and the Federation's outstanding bilateral claims on former member countries of the E.P.U. arising from the liquidation of the Union. In addition, this item contains consolidated loans to countries whose currencies are not convertible. These have normally originated in 'frozen' swing credits. They are repaid in convertible currency in accordance with a set redemption programme.

15. OTHER ASSETS

This item is made up predominantly of the many suspense items and items in course of settlement which are an inevitable part of a central bank's balance sheet. It also contains sundry assets and accounts forming part of the Profit and Loss Account which have not yet been closed.

LIABILITIES

16. BANK-NOTES IN CIRCULATION

In this item are shown the total of notes placed in circulation (not counting coin), including an estimate for the quantity circulating abroad and notes lost, destroyed while in circulation or otherwise missing.

17. DEPOSITS

Deposits are shown according to the following categories of depositors: credit institutions, public authorities and other non-bank

depositors. The deposits of credit institutions must, although they may fluctuate from day to day, be sufficient, taking the monthly average, to meet the minimum reserve requirement. Any surplus reserves are small and are due solely to inevitable miscalculations. The deposits of the public administrations are based on the statutory deposit obligation; even if there were no such obligation, however, the main public administrations would still probably keep substantial balances with the Bundesbank because, as fiscal agent, the Bundesbank attends to payment transactions on behalf of the public administrations.

18. LIABILITIES IN RESPECT OF FOREIGN BUSINESS

This class of liabilities arises from the rôle played by the Bundesbank in the settlement of payments with foreign countries.

19–21. AMOUNTS PLACED TO RESERVE FOR SPECIFIC LIABILITIES, CAPITAL AND RESERVES

These balance-sheet items are of the same nature as those in the balance sheets of limited liability companies.

22. OTHER LIABILITIES

These, again, are the many (liability) suspense items and items in course of settlement; also accounts forming part of the Profit and Loss Account which have not yet been closed.

BANK OF ENGLAND

I

ORIGINS AND LEGAL FRAMEWORK

The Bank of England was established in 1694 under a royal charter. It was the first public bank (i.e. capitalized by public subscription) in England as distinct from the private bankers (i.e. partnerships) of different origin. It was a bank of issue as well as a deposit bank and that was a new thing, since, broadly speaking, the public banks in Europe were not banks of issue. Over the years the functions and objects (not necessarily defined) grew and changed. Its position as government banker and manager of the government debt grew out of its loans to the government and consequent relations with the Treasury and was defined where necessary in a series of Acts. Its position as a bankers' bank and lender of last resort grew from the position of dominance in the City which it attained in the course of time.

The Bank's Head Office is in London. It has eight branches situated in Birmingham, Bristol, Leeds, Liverpool, Manchester, Newcastle, Southampton and at the Law Courts in London. The Bank has no branches outside England. Partly this is because the Scottish and Irish banks themselves issue their own notes. They are not legal tender and are almost entirely covered by the deposit of legal tender in London at the Bank of England.

The main authority for the present constitution of the Bank is the Bank of England Act of 1946 and the new Charter which came into force simultaneously. Under the Act the government bought out the existing stockholders. Additionally there are a series of enactments and statutory instruments going back over a long period, which will be referred to as may be necessary. The legal status of the Bank is that of a chartered corporation with perpetual succession.

The capital of the Bank is £14,553,000. The capital stock is entirely held, on behalf of the government, by the Treasury solicitor. It carries no voting rights.

The Bank Charter Act of 1844 provided for a weekly Bank return to be published and for separating the note issue and its backing from the general banking liabilities and assets of the Bank. The Act therefore provided in name for a Note-Issue Department

and a Banking Department, but there is no corresponding organizational separation in the Bank. The Issue Department is concerned solely with the note issue and the security cover for the notes. Under subsequent statutes[1] the whole net income of the Issue Department is paid to the Treasury (and at present paid by the Treasury into the Exchange Equalisation Account). Any capital loss or profit is also adjusted weekly by debit or credit to the Exchange Equalisation Account.

A half-yearly payment is, by statute, made to the Treasury from the Banking Department, equal in amount to the interest payable on the government stock which was issued to the holders of Bank of England stock when it passed into public ownership. This statutory payment may be varied either way by agreement between the government and the Bank to suit changing circumstances. The profits of the Banking Department are subject to taxation like those of any other company in the United Kingdom.

Under the Bank of England Act of 1946,[2] the Treasury may give such directions to the Bank as, after consultation with the Governor, it thinks necessary in the public interest. Subject to any such directions (and none has as yet been given) the management of the Bank in law and in practice resides in the Court of Directors.

The Bank provides a full banking service and maintains accounts for H.M. Government, banks, accepting houses, discount houses, etc., overseas central banks and sundry private customers including the staff. A large part of the Bank's operations is, however, determined by government monetary and financial policy and by substantial transactions on government account. The Bank cannot, in practice, have a monetary policy separate from that of the government, as indeed it recognized for many years preceding the 1946 Act, but its day-to-day monetary management is carried out at its discretion within the framework of the government's monetary policy.

II

FUNCTIONS AND OBJECTIVES

The objects of the Bank, as stated in the original Charter and still holding good, are to promote 'the publick Good and Benefit of our People'. These objects are nowhere further defined. Largely by tradition and usage, however, certain objects of the Bank have become implicit. These may be enumerated as follows:

[1] Currency and Bank-Notes Acts of 1928 and 1939. [2] Section 4.

(i) to provide a good note issue;
(ii) to be the custodian of the credit and reputation of the banking and financial system;
(iii) to promote orderly financial and exchange markets;
(iv) to defend the value of the currency;
(v) to promote the orderly flow of capital in the capital market;
(vi) to be the lender of last resort;
(vii) to be a confidential and expert adviser to the government of the day;
(viii) to be the registrar for the public debt, which is specifically regulated by statutes and statutory instruments.

III

STRUCTURE AND ADMINISTRATION

THE GOVERNING BODY

The governing body of the Bank is the Court of Directors, which consists of the Governor, Deputy Governor and sixteen Directors, all appointed by the Crown. The term of office of the Governor and Deputy Governor is five years; that of the Directors four years, with four retiring each year; retiring members are eligible for reappointment. There is no limitation on choice except that a member of the Court may not be an alien, a Minister of the Crown, or a Member of the House of Commons, nor be in paid employment in a government department.[1] No formal or representative qualifications are laid down and the objective is a Court composed of men of affairs of wide experience, including some members who are expert in central banking. It has become customary that no Director shall be on the board of one of the large banks and that at least one Director shall be close to the trade unions. There is no maximum age but it is customary not to serve after the age of seventy. It would not be considered wise for members of the Court specifically to represent sectional interests. The direction of the Bank is at all times governed by its corporate view of the best interests of the community.

The Governor and Deputy Governor must give the Bank their exclusive services. The Court may choose not more than four Directors also to give exclusive services; they are known as Executive Directors. Once appointed, the Governors and Directors are secure in their term of office, subject to the disqualifications laid down in the Act of 1946[2] and the Charter of 1946.[3] Individually they are

[1] Certain other disqualifications can apply, for which see Section 8 of the Charter of March 1, 1946.
[2] Section 4 of the Second Schedule to the Bank of England Act of 1946.
[3] Section 8 of the Charter of 1946.

under no political or governmental control and the Court as a body is subject only to directions from the Treasury as mentioned earlier in Section I. The Court is required to meet at least once a week; it normally meets on Thursdays.

The Court, for the purpose of policy and administration, resolves itself into a number of regular committees,[1] specified below. Special committees may also be formed *ad hoc* as occasion may dictate.

The standing committees are as follows:

1. Committee of Treasury;[2]
2. Audit Committee;
3. Committee on Permanent Control of Expenditure;
4. Staff Committee;
5. Committee to Consider the Securities of Certain Funds;
6. Debden Committee;
7. Charitable Appeals Committee;
8. Committee on Bank Premises.

The key committee and the largest (seven members) is the Committee of Treasury. It comprises the Governor, Deputy Governor and five Directors; the Court elects these Directors annually by secret ballot, it being an established rule that not more than one of them should be an Executive Director. One or more of the Executive Directors serve on each of the other committees.

The Committee of Treasury is the policy committee of the Bank and sifts the reports of all other committees before submission to the Court.

The other standing committees concern themselves with issues common to a large business enterprise and the titles are largely self-explanatory. But a word of explanation on two of them is necessary.

The Committee on Securities examines periodically, and reports upon, the investments of various internal funds, and of certain sinking funds, etc., of which one or other of the Governors may be *ex officio* a Trustee.

The Debden Committee examines and reports upon the administration, equipment, methods of work and the finance of the Bank of England printing works.

In addition to participating in the committees a number of Directors serve on the joint Council of Directors and Staff, a body which enables Court and staff to explore points of view in relation to matters affecting the staff of the Bank.

[1] Charter of 1946, Section 5.
[2] Not to be confused with H.M. Treasury.

ORGANIZATION

The Head Office of the Bank is organized into a number of main departments. These departments have a number of divisions which are called offices, most of which need not be described. The organization is subject to alteration only by the Court to take account of changing circumstances and the need to meet new situations.

The present organization is as follows:

1. The Cashier's Department.
2. The Accountant's Department.
3. The Central Banking Information Department.
4. The Establishment Department.
5. The Secretary's Department.
6. The Audit Department.

In addition, there is the Bank of England printing works at Debden, Essex, where the Bank's notes are printed and where other security printing as well as a certain amount of ordinary printing is done. Normally, printing for other than Bank purposes is not done there.

There is also a small body of Advisers to the Governors who are not members of any department.

A brief description of the purview of these departments would be useful.

1. The Chief Cashier is the chief executive officer of the Bank and his department is the operating department concerned with the note issue, all banking operations, those exchange control duties delegated to the Bank by H.M. Treasury and the management of the Exchange Equalisation Account (on behalf of H.M. Treasury), about which more will be said later. The branches, in effect, form part of this department and one of the offices of the department is specially charged with branch matters. In addition to the banking offices concerned with accounts, collection of cheques, bills, etc., certain offices deserve specific mention.

(*a*) The Discount Office is primarily concerned with money-market houses and it is to this office that market borrowers apply for accommodation. It is also a repository of knowledge of the financial standing of banks and other businesses.

(*b*) The Loans Office is concerned with the issue of loans and Treasury bills and the payment of interest warrants.

(*c*) The Dealing and Accounts Office is responsible for operations in gold and foreign exchange.

(*d*) The Exchange Control Office, in administering the Exchange Control Act of 1947, deals with the general administration

of the control of transfers of funds and securities between residents and non-residents.

(*e*) The Commodities Office maintains contact with the various commodity markets and has certain exchange-control supervisory functions in relation thereto.

(*f*) The Chief Cashier's Office is the hub of the department.

In addition to providing normal banking services, particularly to government bodies in their areas, the branches, except the Law Courts branch, broadly serve four purposes. First, they act as note-distribution and collection centres; secondly, they operate local clearing-house accounts; thirdly, and within defined limits of power, they administer locally the Exchange Control Act; and fourthly, they serve as a point of contact with commerce, industry and agriculture. The first three purposes are for the convenience of the commercial banks and general public. The fourth purpose is for the benefit of Head Office, which requires to be informed of local conditions and opinions and the trend of business. The Law Courts branch exists primarily for the operation of various accounts for the Public Trustee and accounts connected with the administration of the law.

In addition to its eight branches, the Bank maintains an office in Glasgow primarily for the administration, in Scotland and Northern Ireland, of the Exchange Control Act in the same way as the branches operate in England. This office carries out no banking functions, but it provides a point of contact with industry.

2. The Chief Accountant is no longer responsible for the Bank's accounts, as his name would imply. He is the registrar for that portion of the National Debt domiciled at the Bank. His department is responsible for the registers of stock maintained for the government and others, for example nationalized bodies, some Commonwealth governments, several United Kingdom local authorities and a few other public bodies. He is responsible for recording all transfers of stock and for the issue of interest warrants. The department, now extensively mechanized, is large because, in particular, of the magnitude of the government debt. The number of stock holdings runs into millions. The Chief Accountant also has a statutory duty[1] to see that the Chief Cashier properly disburses money made available by H.M. Treasury for the payment of interest on government debt.

3. The Central Banking Information Department is a relatively new creation to bring into one department a number of activities previously carried out in different departments. The department is

[1] The National Debt Act of 1870, Section 16.

not concerned with the actual banking operations on the accounts maintained with the Bank by overseas central banks. It is concerned with such central-banking activities as the collection and interpretation of current financial and economic information relating to home and overseas affairs; with the initiation, and carrying-through, of action in overseas matters; with relations with overseas central banks and international bodies such as the International Monetary Fund, the International Bank for Reconstruction and Development and the Bank for International Settlements. It is also concerned with such published information as the Bank's Annual Report and Quarterly Bulletin.

4. The activities of the other departments are self-evident from their titles. The Establishment Department is concerned with the staff and Bank premises. The Secretary's Department is concerned with matters falling within the normal duties of a secretary and accountant of a company. The Audit Department maintains a continuous internal audit and the Auditor is directly responsible to the Governors. The Bank also employs the services of outside auditors.

5. The Bank has no legal department or staff of lawyers, but has for many years consulted a leading firm of solicitors when it requires legal advice and through them has the services of legal counsel whenever necessary.

PUBLICATION OF ACCOUNTS AND OTHER INFORMATION

The Bank is under a statutory duty[1] to publish a statement of assets and liabilities weekly. This is the Bank return. The figures are as at the close of business of each Wednesday. A specimen of the current form is included in the annex.

Apart from the Bank return the Bank publishes an Annual Report and Quarterly Bulletin which discuss monetary policy and economic and financial conditions both at home and abroad. They also include a selection of financial statistics.

The gold and foreign exchange reserves of the country are owned by H.M. Government and not, except for a token amount, by the Bank. The government publishes the amount of the reserves every month.

IV

POWERS AND ACTIVITIES

Under the original Charter the Bank is authorized 'to have, take, purchase, receive, hold, keep, possess, enjoy, and retain . . . any

[1] Bank Charter Act of 1844; Currency and Bank-Notes Act of 1928; and Coinage Act of 1946.

Manors, Messuages, Lands, Rents Tenements, Liberties, Privileges, Franchises, Hereditaments, and Possessions whatsoever and of what Kind, Nature, or Quality soever; and moreover, to purchase and acquire all Goods and Chattels whatsoever, . . . and also to sell, grant, demise, alien, and dispose of the same Manors, Messuages, Lands, Rents, Tenements, Privileges, Franchises, Hereditaments, Possessions, Goods and Chattels or any of them'. The Bank's power to engage in the business of banking was specifically reaffirmed by statute, in particular the Bank of England Act of 1833.

It will be seen, therefore, that the Bank's general powers of operation in relation to its banking activities are, for practical purposes, uninhibited. The restrictions on its activities are self-imposed. The Bank's practices will be briefly dealt with hereafter.

Certain fundamental central-banking activities, in particular the note issue, and financial relations with the government are dealt with under separate legislation.

NOTE ISSUE

Before 1914 the issue of legal tender as an attribute of sovereignty was largely confined to the Royal Mint, of which the Chancellor of the Exchequer is, *ex officio*, the Master. The Mint issued full legal-tender gold coin and subsidiary coin which was limited legal tender. The regulating legislation was the Coinage Act of 1870. Bank of England notes were also legal tender and payable on demand in gold coin. At the beginning of the century Bank of England notes were covered by gold coin and bullion except for a small fiduciary issue. A Bank of England note was therefore in effect a gold coin certificate.

Under the Currency and Bank-Notes Act of 1928 the currency note issue (which dated from August 1914) was transferred to the Bank of England from the Treasury. Since then the Bank of England has had the sole right to issue legal-tender bank-notes of £1 and 10s. denomination in the United Kingdom. Bank of England notes of denominations of £5 and upwards remain legal tender in England and Wales only.

In 1931 the convertibility of Bank of England notes into gold at a fixed price was abandoned.[1] In 1932 an Exchange Equalisation Account was established to check undue fluctuations in the exchange value of sterling. This account is a Treasury account. As the whole of the country's gold reserve (except for a token amount) was transferred to the Exchange Equalisation Account in 1939, virtually the entire note issue is a fiduciary issue. The amount of notes that can be issued was fixed at £1,575 million in the Currency and Bank-

[1] Gold Standard (Amendment) Act of 1931.

Notes Act of 1954. Flexibility was retained, however, by providing that, on representation by the Bank, the Treasury might direct that the fiduciary issue should be such amount as might be agreed between it and the Bank. Parliamentary sanction, in the form of an order under the Currency and Bank-Notes Act of 1954, must be obtained for the maintenance of any increase for a period of more than two years.

Under the provisions of the Currency and Bank-Notes Act of 1939 the assets of the Issue Department are valued every week. Any depreciation is made good by a transfer from the Exchange Equalisation Account and any appreciation is transferred to that Account. The profits of the Issue Department are also paid to the Exchange Equalisation Account by virtue of the Currency and Bank-Notes Act of 1939.

Finally, under the Currency and Bank-Notes Act of 1954, the Bank may issue notes of such denominations as the Treasury may approve. The present denominations of legal-tender notes are £5, £1 and 10s. It is proposed to issue a note of £10 denomination in due course.

OPERATIONS

As mentioned earlier, the Bank, apart from its note issue, enjoys by virtue of its Charter a wide discretion in the types of operation it may carry out. Over the years, however, it has built up a tradition of central banking and of self-imposed limitations on the type of business it transacts. It has sought for many years to restrict its private business.

ACCOUNTS

The Bank maintains accounts for the government, for banks, including overseas central banks, for a residue of private customers who have had accounts from many years past and wish to maintain their banking relations with the Bank, for members of the staff, which includes pensioners of the Bank, and accommodation accounts for money-market houses to enable them to borrow from the Bank on approved security or to discount bills. No institution has a prescriptive right to an account at the Bank and new accounts are largely restricted to those that are deemed to serve a public purpose. Overseas central banks which do commercial business in London are encouraged to place that part of their business with another bank in London and to use the Bank of England only for central-banking business.

The Bank receives money only for non-interest-bearing current accounts. It will, however, invest funds in accordance with customers' wishes.

Special deposits, which may be called from the banks from time to time as a measure of credit control, will be dealt with later.

LOANS AND DISCOUNTS

The Bank will make advances on security to customers for approved purposes. It is not the practice of the Bank to make unsecured loans. The Bank does not grant accommodation by way of overdraft. Its advances to the Exchequer are limited to 'Ways and Means' advances. The limit of such advances and their duration are fixed annually by the Appropriation Act passed each year to implement the Budget. Ways and Means advances partake of the nature of overnight accommodation and are adjusted at the close of business each day as necessary. The occasions for such advances are relatively infrequent, since the net cash positions of government departments are estimated with some precision every day and adjusted by sales or purchases of Treasury bills.

The Bank's advances to the market are at or above Bank rate and are for a minimum period of seven days secured by the deposit of either Treasury bills, other approved bills of exchange or short-dated government bonds. Market dealings therefore tend to be concentrated on paper of these kinds, which are eligible as security at the Bank.

The Bank will discount for customers Treasury bills or other bills of exchange having not more than 126 days to run, at the current market rates of discount for the kind of paper involved. The bills of exchange must bear two approved British names, of which one must be that of the acceptor, and be authorized by a Governor or Executive Director. Limits of amount are set for any name taken.

The same rules apply to discounts for market borrowers, except that the discount rate is currently the Bank's published rate of discount. Market borrowers tend to obtain accommodation by way of seven-day advances rather than by discount. The Bank at all times retains discretion as to the paper which it will take for discount or as security for a loan.

PURCHASES AND SALES OF BILLS AND SECURITIES

As the Bank return shows, the bulk of the Banking Department's assets consists of government securities, which of course include Treasury bills. It may also buy other bills in order to maintain its familiarity with the kinds of paper finding their way onto the market.

FOREIGN EXCHANGE AND GOLD

The Bank will buy or sell foreign exchange and gold on behalf of customers, which include government departments and overseas central banks. An important part of its operations is carried out as manager of the Exchange Equalisation Account on behalf of the Treasury.

BAILEE

The Bank acts as a bailee chiefly in holding for safe custody customers' securities, boxes and gold.

ISSUE OF LOANS

The Bank issues loans on behalf of customers, most of the Bank's work in this regard being for the government. The Bank's work as registrar of government and other loans has already been mentioned. The Bank does not underwrite loans. The procedure for dealing with government loans is dealt with later. Underwriting of loans for other customers is arranged in the market.

CAPITAL ISSUES CONTROL

Operations involving the issue of capital and the borrowing of money (with various exceptions such as the borrowing a bank does in receiving a deposit, and the borrowing from a bank in the ordinary course of business) are subject to the permission of the Treasury, under powers derived from the Borrowing (Control and Guarantees) Act of 1946. A Treasury order of August 3, 1961, gives general permission for almost all such operations except those in connection with capitalization of reserves in cases where redeemable securities are involved, borrowing by borrowers not resident in the United Kingdom and borrowing by local authorities. Prospective issues by residents outside the United Kingdom are first considered by a committee (called the Capital Issues Committee) which makes recommendations to the Treasury as to whether or not issues should be permitted. The timing of any borrowing by an issue of £1 million or more must be agreed with the Bank of England, acting on behalf of the Treasury. It is from this provision that the Bank derives formal authority to regulate the approach of borrowers to the capital market.

EXCHANGE CONTROL

Under the Exchange Control Act of 1947, dealings in foreign exchange and gold and sterling transactions involving money or securities with residents outside the Scheduled Territories[1] are

[1] Areas outside the United Kingdom scheduled by H.M. Treasury under the Exchange Control Act of 1947.

subject to the permission of the Treasury. Exchange control policy is formulated in consultation between the Treasury and the Bank of England. The Bank of England is primarily concerned with financial transactions subject to exchange control and acts as the agent of the Treasury in administering and notifying to the banking system general permissions under the Act and administering special permissions or policy decisions in individual or special cases. The Treasury, on the Bank's recommendation, delegates a large part of the administration to the banks themselves by means of a number of exchange control notices. All banks authorized to act on behalf of the Treasury for exchange control purposes are called authorized banks. As regards transactions in securities, these banks and others have been appointed authorized depositaries for the purpose of holding certain securities marketable abroad owned by residents. The Bank, acting under its authority from H.M. Treasury, deals with special cases, interprets where necessary to the authorized banks, and itself gives rulings and consults with and informs the Treasury as appropriate.

RELATIONS WITH BANKS

Formally the Bank's relation with the other United Kingdom banks is that of banker and customer. The other banks maintain accounts ('bankers' deposits') with the Bank as part of their cash reserve and use them for clearing net transfers to other banks arising through the clearing or otherwise, for transfers to the Exchequer, or for drawing notes for their till money. Conversely, they pay surplus or soiled notes into the Bank for the credit of their accounts. As a matter of practice the banks do not seek accommodation from the Bank. The banks adjust their cash position by calling loans from the discount market or selling investments in the gilt-edged market.

The Bank does not formally inspect or supervise the policies or operations of the clearing banks. Although the Bank of England Act of 1946 authorized the Bank 'to request information from and make recommendations to bankers' and, if authorized by the Treasury, to enforce a recommendation by a direction, no such formal recommendations or directions have been issued. But the Bank keeps in close informal touch with the banks and the Governor of the Bank has ample opportunities to make his views known to the chairmen of the banks.

There are no statutory requirements in relation to liquidity or cash reserves.[1] But the banks, in agreement with the Bank of

[1] There is no separate Bank Act in the United Kingdom. The majority of banks are companies incorporated under the Companies Act (a few were established under royal charters).

England, voluntarily maintain a cash ratio of 8 per cent and a minimum ratio of liquid assets (cash, money at call, bills of exchange including Treasury bills) of 30 per cent to gross deposits. The banks, in the prosecution of their business, regard it as prudent to maintain a measure of liquidity, and the figure of 30 per cent is one which, in general, they have come to regard as a yardstick by which to work.

RELATIONS WITH INTERNATIONAL INSTITUTIONS

The Bank acted as the agent of the government for the implementation of the European Payments Agreement; that involved considerable operational activity. The Bank now acts as agent on behalf of the government in the implementation of the European Monetary Agreement.

The Bank also acts as an official channel of communication between the British Government and the International Monetary Fund and the International Bank for Reconstruction and Development. The Bank, in its own right, is a shareholder of the Bank for International Settlements.

V

MONETARY POLICY

Monetary policy forms part of the government's general economic policy and ultimate responsibility for it lies with the government. The Bank is responsible in its own field for monetary management within the framework of the current monetary policy. Although the ultimate responsibility is for the government, the Bank has a powerful voice in the framing of monetary policy. Recently arrangements have been made for the Bank to be permanently represented on the various official committees by which economic policy is formulated and advice to Ministers on it is co-ordinated. With many of these committees the Bank had already been informally associated from time to time.

The day-to-day work of the Bank in connection with monetary management is largely conditioned by the net flow of payments between the government and the financial community and the net flow of funds between external and domestic holders of sterling. The net cash position of the government is cleared through its account at the Bank. Payments out of the government accounts at the Bank serve to increase other deposits in the Bank, chiefly of course the bankers' deposits, and vice versa. The Bank's operations in the money and securities markets may neutralize such movements

or accentuate them according to current policy and opportunities. The Bank's operations in total therefore influence the liquidity structure of the whole economy.

The Exchequer account, the central account of the government, is kept at the Bank, as are several subsidiary accounts. They appear in the Bank return under the heading 'Public deposits'. The services which the Bank performs from day to day are in essence like the services of any banker to a customer with a current account: the receipt of moneys, the making of out-payments, and occasional overnight assistance (Ways and Means advances) if the account is drawn down temporarily below the agreed minimum balance because of some unforeseen circumstances. A most important part of the Bank's relations with the government is the giving of objective, expert advice over the whole range of financial and currency policy.

The Bank also manages the Exchequer borrowing from the market.[1] The tenders for each week's issue of Treasury bills (which are the means by which the needs of the Exchequer are met, in so far as they are not covered by longer-term borrowing) are lodged at the Bank and opened and allotted in the presence of a representative from the Treasury. The highest tenders are accepted up to the total amount which it is decided to allot. The subscriptions for Treasury bills are received by the Bank and credited to the Exchequer. The Bank pays the bills on maturity and debits the Exchequer. The Bank also handles new issues of government and government-guaranteed bonds and stock, whether for cash or conversion; it advises the government on the terms appropriate for an issue, publishes the prospectus, receives applications and allots and issues the bonds or stock.

At the heart of its work as the central bank lie its market operations in government securities and Treasury bills. The Bank carries out operations in the money market designed to influence the cash reserves of the banking system. These follow in the tradition of open-market operations as commonly understood over the past thirty years or more. But the Bank's market operations have greatly widened in scope and diversity. A task which the Issue Department has assumed over recent years, largely as the result of the growth of government debt, is the active management—marketwise—of that debt. This involves many security transactions on the market and, although the primary objective is not monetary management, nevertheless these market operations can and do affect the reserve position of the banking system and have to be taken into account in monetary management.

[1] For a brief account of the institutional framework of the monetary system, see the memorandum 'The British Monetary System: Institutional Framework' on pages 5–9 of Vol. 1, Principal Memoranda of Evidence, Committee on the Working of the Monetary System, H.M.S.O., 1960.

The Bank operates almost daily in the money market. It buys and sells Treasury bills from and to the market, thus either putting out cash or taking in cash, to smooth out shortages and surpluses of funds between one day and another, which arise mainly out of the uneven incidence of payments by and into the Exchequer. An essential purpose of these operations is to maintain an orderly market. (The Bank may operate with other objectives in mind and this is dealt with later.) The Exchequer needs the money market to take care of its cash requirements; but the amounts of cash that must pass between the banking system and the Exchequer are so large, and the incidence of payments and receipts is so varied, that, if the market were left to itself, the movement of cash from and to the Exchequer would create alternate excesses and shortages in the market which would cause wide fluctuations in the price of short-term borrowing (i.e. the short-term interest rate). As the largest borrower in the money market, it is in the government's interest that an orderly market should be maintained and that short-term interest rates should not fluctuate widely from day to day.

The Bank may also operate in order to move short-term rates in a desired direction. If it wishes to raise market rates relatively to Bank rate the first step is to increase the supply of bills. This is normally done by increasing the amount of bills offered at the weekly tender above the level needed to finance the requirements of the Exchequer, the Exchequer using the surplus funds to buy in Treasury bills held by the Banking Department. As the discount market, by convention, covers the tender (i.e. puts in applications for the full amount offered), the resultant increase in the supply of bills to be paid for will cause a shortage of money in the market and may involve the market houses in borrowing direct from the Bank at Bank rate.

Open-market operations in Treasury bills are conducted through a firm of discount brokers. The Bank does not itself deal directly with the market for these operations, but their origin is readily identifiable because of their nature and size and the broker employed.

The Bank's operations in gilt-edged (i.e. government) securities are undertaken to further monetary policy by funding short-term government debt. 'Funding' is here used in a rather special sense, which has only recently become accepted, to mean the process of lengthening the average life of government debt in the hands of the general public, whether by the sale of stock, the proceeds of which are used to redeem Treasury bills, or by providing longer-dated stock for shorter issues. This process has been a cardinal aim of policy since the war, because the large quantity of Treasury bills and frequent maturities of short-term bonds have made effective credit control by open-market operations very difficult. The Bank

and the government therefore have been constantly concerned, in addition to covering by security sales as much as possible of any overall government deficit, to lengthen the average life of the public debt and to reduce the large volume of short-dated debt. For this purpose use is made of the large security holdings of the Issue Department of the Bank as a trading stock on which to base dealings designed to lengthen the average life of the debt and to facilitate new issues and redemption and conversion operations. This is not a rôle which was contemplated in the statutes which set up and govern the Issue Department but one to which it has been gradually adapted to meet emerging needs. To a much lesser extent similar use is also made of the security holdings of the National Debt Commissioners. Apart from sinking funds, these consist largely of securities held against the deposits in the Post Office Savings Bank and Trustee Savings Banks and for the various national insurance funds. These securities, of course, can only be used where the operation is fully consonant with the interests of the particular fund for which they are held. The National Debt Office, which holds these securities, keeps in close contact with the Bank in all its operations, and both the Bank and the National Debt Office put all their dealings in the hands of a single firm of brokers, whose senior partner is universally known as 'the Government Broker'. Strictly speaking, his only official appointment is that of broker to the Commissioners for the Reduction of the National Debt. It should be understood, however, that this firm of brokers also acts for many other clients in placing orders with dealers in securities, both gilt-edged and of other kinds.

So far as new issues are concerned, the system employed is for the Bank (on account of the government) to announce the issue of a loan and invite applications from the public. It is not expected that the public will immediately subscribe enough to cover the issue. The loan is closed and 'fully subscribed' by the departments (which in practice almost always means the Issue Department) taking up that part of the loan which has not been subscribed by the public. In this way the departments are sometimes said to 'underwrite' these issues, though the term is misleading in that it suggests prior agreement on terms and the payment of a commission. The departments then peddle the stock on the market as opportunity offers. In this way the government is enabled to make the issue of stock to the public an almost continuous process, and the Bank by its operations can exercise an influence on yields and on the prices in the gilt-edged market. The price at which the Bank is prepared to deal in the stock or stocks which it is peddling on the market at any particular time becomes an important factor in prices generally in the gilt-edged market. Two particular considerations therefore play a part in a decision to make a new government issue. First there is the size of

any particular near-maturity, and secondly the need for the Issue Department to have available for sale an amount of stock of suitable maturities. The Department, in addition to selling new stock, is also habitually buying the stock which is next maturing. This has the effect of reducing the amount of maturing stock with consequent advantage in managing the movements of cash on the day of redemption, whether or not a conversion issue is also made at the time. The government is thus refinancing its debt as a continuous process. The Issue Department finances its operations by adjusting its holding of short-term government debt. To the extent that it takes up a new issue or buys a maturing issue it allows short-term debt to run off. The latter may mean an increase in the total of Treasury bills held by the private sector. To the extent that it is a net seller of stock it lends the proceeds to the Exchequer at short term. Net sales of stock enable the authorities to finance an Exchequer deficit without adding to the issue of Treasury bills, which might well increase the liquidity of the banking system. If net sales exceed the Exchequer deficit the total issue of Treasury bills is *pro tanto* reduced and probably also the liquidity of the banking system. For the foreseeable future the need to fund the short-term debt of the government will remain a major factor in monetary management.

The Bank conducts operations in foreign exchange and gold. The Bank manages the Exchange Equalisation Account, about which some further explanation is required here. The Account, established in 1932,[1] although intended primarily for 'checking undue fluctuations in the exchange value of sterling' also facilitated to some extent the insulation of the domestic economy from the effects of an inflow or outflow of gold or foreign exchange. In 1946 the purposes of the Exchange Equalisation Account were widened to include the conservation or disposition in the national interest of the means of making payments abroad.[2]

It is worth while to draw attention to the difference in the statutory provisions governing the Issue Department on the one hand and the Exchange Equalisation Account on the other, since these are reflected in different relationships between the Bank and the Treasury in the internal and external fields. The assets of the Issue Department are the assets of the Bank and their composition is therefore the responsibility of the Bank, despite the provision that the net income of the Department is to be paid to the Treasury and any depreciation or appreciation to be dealt with by transfer from, or to, a government account. Nevertheless, the Bank is under a statutory obligation to give to the Treasury any information about

[1] Finance Act of 1932, Part IV; Exchange Equalisation Acts of 1933 and 1937; Currency Defence Act of 1939; and Currency and Bank-Notes Act of 1939.

[2] Finance Act of 1946.

the securities in the Issue Department which the Treasury may require. The Exchange Equalisation Account, however, is a government account and the rôle of the Bank in managing it is no more than that of agent.

The Account was initially given a capital sum in sterling by the Exchequer. This was to a large extent a book-keeping transaction, since in so far as the capital was not required to acquire and carry holdings of gold or exchange it was (and is) lent back to the Exchequer, chiefly by purchase of Treasury bills. A small balance which may be required for day-to-day operations is placed with the Exchequer in the form of Ways and Means advances (public departments). The total capital of the Account is adjusted upwards or downwards from time to time as circumstances require.

If an inflow of gold or foreign exchange occurs, this will not necessarily lead to an increase in the note issue or deposits at the Bank of England, i.e. in the cash base for credit. The gold is acquired by the Exchange Equalisation Account against sterling which is paid to the London banker acting for the seller. To find the necessary sterling the Account calls some of its Ways and Means advances from the Exchequer; or it may sell Treasury bills to another departmental account, which in turn (and ignoring all other movements) would need to call Ways and Means advances. The Exchequer must then find the money and, other things being equal, would have to increase correspondingly its borrowings in the market by selling Treasury bills. These borrowings in effect draw back from the market the cash that is paid out by the Account. Similarly, if an outflow of gold or exchange occurs, the sterling equivalent passes, on the orders of the buyer of the gold or exchange, from a London bank to the Exchange Equalisation Account. This sterling is lent to the Exchequer, whose need to borrow in the market is *pro tanto* reduced. The amount of Treasury bills is less than would otherwise have been the case, thus offsetting the drain of cash from the market to the Account.

The practical effect is thus to increase or decrease the amount of Treasury bills held by the private sector. Since the banks rightly regard Treasury bills as liquid assets and near cash, to the extent that the banks increase or decrease their Treasury bill holdings their liquidity is affected and consequently their ability to create credit.

Under this arrangement, therefore, the former automatic link between movements of the gold reserve and the money supply via the note issue was severed. The effects of an inflow or outflow of gold or foreign exchange depend on the nature of the transaction. Formerly an inflow added both to the cash reserves of the banks and to their deposits unless the Bank offset the effects by open-market operations. Under the new system the effect upon the banks'

deposits depends on who buys the Treasury bills. If the banks buy the Treasury bills, or lend money to the discount market to buy them, their deposits and their liquid assets are increased by a similar amount. Their cash is not increased and there is therefore some tightening of cash ratios. But this is not significant because the banks can make good any shortfall in their holdings of cash so long as they have an adequate supply of liquid assets. (If need be in the end they may compel the discount market to borrow cash from the Bank of England.) The initial rise in deposits and any secondary increase later induced by the increase in liquidity may help to cause a growth in spending and this will raise the public's demand for notes. But if the Treasury bills are not purchased by the banks or the discount market but by some other holder in the private sector, the figures of the banks are unaffected.

It remains true, therefore, that an inflow of gold or foreign exchange is likely to increase the banks' deposits and liquid assets and thus their liquidity ratios; but the increase is unlikely to match exactly the inflow. An outflow of gold or foreign exchange works in the opposite direction. The effect on the liquidity of the banks of an inflow or outflow is no more than one factor among others to be taken into account in the daily and longer-term problems of credit control.

The Bank's operations in the foreign exchange and gold markets rest upon the obligation laid down in the Finance Act of 1932 that the Exchange Equalisation Account should be used for the purpose of checking undue fluctuations in the exchange value of sterling. In particular, at present, there is an overriding obligation to maintain the exchange value of the pound in international markets within the limit rates of $2·78–2·82 to the pound. But, in addition to intervening without limit as to amount at these extreme rates, the Bank of England does in fact intervene quite actively and quite regularly in the exchange market in order to maintain relative day-to-day stability in the exchange value of sterling. Such intervention is made mainly in terms of U.S. dollars, since the largest international market for sterling is in fact in terms of the American currency; but intervention does also take place through purchases and sales of gold and from time to time of other currencies depending upon the condition of the markets at the time. While an obligation has been accepted to maintain spot quotations for the pound in the exchange markets within determined margins of fluctuation, no such obligation exists in relation to forward quotations. In principle, forward quotations for the pound are allowed to fluctuate in accordance with supply and demand. This does not mean that the Bank of England never operates in forward exchange—forward operations are entered into from time to time—but any such operations are not made with a view to containing forward rates within any pre-

conceived limits or for the purpose of holding them at any predetermined level.

A recent development has taken place in regard to Bank rate. While this had always been fixed (except in emergencies, when the Governor acted) by the Court of Directors of the Bank, it became the practice many years ago, before deciding any change, to make sure that the move was acceptable to the Chancellor of the Exchequer as being in harmony with government policy. Under the new arrangements the Court of Directors has delegated to the Governor of the Bank standing authority to settle changes in Bank rate with the Chancellor of the Exchequer on behalf of the Bank. In arriving at a view of the level of Bank rate the Governor is free to have discussions with the Directors but specific proposals are not put before the Committee of Treasury or the Court of Directors. After customary informal discussions with the Chancellor, if a change in Bank rate is agreed the Governor makes a formal written proposal to the Chancellor before the change is made and the Chancellor gives formal approval in writing. That approval covers both the change and the continuance of the new rate until a further change is made. At the meeting of the Court of Directors the Governor reports the action taken under the standing authority given to him and the change of rate is announced in the traditional way. A formal announcement is made to the Press, which includes a statement that the change has the Chancellor's approval. Until a further change is made the Governor reports to the Court at its weekly meeting that there will be no change in Bank rate. It is important to stress that changes in Bank rate are shown to be advocated by the Bank as well as approved by the Chancellor.

With this introduction we can now examine the instruments at the Bank's disposal for its task of monetary management. They might be conveniently listed as follows, although the order is not to be construed as an order of preference:

1. Bank rate and discount policy;
2. open-market operations in bills;
3. funding and debt-management operations in securities;
4. operations in the gold and foreign exchange markets;
5. special deposits;
6. informal requests to bankers and moral suasion;
7. recommendations and directions to bankers under the Bank of England Act of 1946;
8. action under the Exchange Control Act of 1947.

In recent history it is only since late 1951 that the use of monetary instruments has been actively revived. For the previous twenty years Bank rate had been held almost constant at 2 per cent and was

largely ineffective and out of touch with the low level of money-market rates (½ to 1 per cent for Treasury bills). Only at the mid-year and year-end did a certain amount of market borrowing at the Bank take place, when the banks amongst others made up their end-of-June and end-of-year statements, which usually meant that the market was short of cash due to the banks' calling cash from the market. The market was therefore usually forced to borrow from the Bank. From 1939 onwards even this limited borrowing was not required.

The period from 1945 to 1951 saw the essay of a planned economy, the extension of wartime controls for peacetime purposes and all in a financial environment of great liquidity with government debt enormously expanded, while the trading position of the United Kingdom had yet to be re-established. Despite gifts and loans to support the re-equipment of the physical capital of the country and the balance of payments, the period saw a devaluation of sterling and a great worsening of the reserves. It was in these circumstances that, amongst other measures, a revival of the use of monetary instruments was decided on by the government. A beginning was made in the active use of Bank rate and open-market operations designed to shift the interest-rate structure. By January 1952 there were several signs that the restoration of movement to short-term interest rates, the rise in the banks' advances rates, a funding of some part of the Treasury bills outstanding (in November 1951), the fall in security and share prices, and opinion that monetary and financial procedures were evolving so as to strengthen the authorities' control over bank credit were producing a different climate of opinion about credit conditions generally.

The effects of changes in interest rates in general, and of changes in one set of rates on others, are partly actual and partly psychological. An expectation of a change in Bank rate will often lead to effects which the expected change, when it occurs, will merely confirm. The ability to make the market borrow at the Bank and the power to vary Bank rate and to charge higher rates for market advances[1] enable the authorities to bring strong direct pressure to bear on the money market to raise the general level of its rates, i.e. call-money rates, commercial-bill rates and the Treasury bill rate. In the United Kingdom the rates paid by the banks and the rates charged by them for advances are also closely linked with Bank rate. The influence of Bank rate (both by actual changes and by the public's attitude to likely future changes) tends to work through to other rates, but the range and strength of this tendency is conditioned by other factors, and not least in the commercial field by

[1] On January 3, 1963, the Bank made it known that it will at its discretion revert on occasion to the pre-war practice of making advances to the discount market at rates above Bank rate.

the view taken about future business prospects and the actual supply of and demand for capital.

A rise in interest rates has important effects, both direct and indirect, upon those who borrow, those who save, and those who lend, and also (most important) on the movement of funds to and from the United Kingdom. This is still the case even though the effects are weakened by the growth of the public sector, by the high level of taxation, by the resilience of business optimism (in a world of expansion policies) and, on the overseas side, by exchange controls and by the greater importance of various confidence factors.

Decisions on changes in Bank rate and market operations are a matter of judgement in a complex of circumstances. Sometimes one set of factors will override other factors. An extreme example may be quoted of the sharp rise to 7 per cent in Bank rate in 1957, at a time when the current balance of payments was not apparently adverse. But the outflow of funds from the United Kingdom as the result of loss of confidence in the sterling rate of exchange, partly generated by exchange rate anticipations for continental European currencies, made the question of external confidence and the fall in the United Kingdom reserves the dominant factors in the decision to raise Bank rate, overriding any domestic considerations which might not justify such a movement.

Operations in the gold and foreign exchange markets are not primarily designed to influence directly the domestic credit situation, although the sterling counterpart to such operations has to be taken into account in day-to-day management of the market. Operations in the gold and foreign exchange markets are more concerned to smooth out exchange rate fluctuations, including maintaining an orderly market. The effect on confidence of movements in exchange rates and in reserves is always a factor in mind.

When the Chancellor's requests on advances (mentioned below) were withdrawn it was announced that, pending the Report of the Radcliffe Committee, if it were felt desirable to restrict the credit-giving of the banks the Bank would, under a voluntary scheme agreed with the London clearing banks and the Scottish banks, call upon the banks to make with it special deposits. The making of such deposits would entail a reduction in the banks' liquid assets and therefore in their ability to grant credit.

The mechanics of the procedure, as now formulated, are to call for special deposits equal to a given percentage of the banks' gross deposits as shown in their monthly statements. The special deposits not being at the free disposal of the banks do not rank as part of their liquid assets. The Bank pays interest to the banks at a rate varying each week with the average rate at the Treasury bill tender on the previous Friday, rounded to the nearest multiple of $\frac{1}{16}$ per

cent. This is designed to give the banks a return broadly comparable with that which they would have earned on Treasury bills. The Bank will normally cover its costs by employing the funds in Treasury bills. Any special deposits outstanding are shown in the Bank return as a separate item. It will be adjusted monthly to accord with the changing figures of the banks' gross deposits, and in accordance with any decision to make a fresh call or make a release. Releases to individual banks to meet some emergency are not excluded, but any request for such a release would be examined on its merits. In all, three calls have been made to date, totalling 3 per cent of gross deposits of the clearing banks and $1\frac{1}{2}$ per cent for the Scottish banks. No call has been made on the other banks, in particular the Northern Irish banks and the private banks. The system is not dissimilar from that employed in Australia and first imposed during the war to prevent in part inflationary consequences from a rise in the deposits of the trading banks.

Informal requests to bankers and moral suasion have long been customary. As we have seen, there are no statutory regulations in respect of cash ratios, liquidity, advances and so on. The banks are, however, kept aware by close and informal contact of the Bank's and government's views on the liquidity and credit policy of the banks generally and, where necessary, specifically. The most controversial and publicized request to bankers in recent years has been the request of the Chancellor of the Exchequer, transmitted through the Governor of the Bank, to the banks in July 1957 to observe a specified ceiling on their advances to the private sector. The banks complied with this request, but reliance on requests had in general certain undesirable consequences in limiting their normal activities and competitiveness. Moreover, the request did not touch other lenders such as hire-purchase finance houses and the like who, in effect, compete with the banks in certain fields of credit-giving, and who were able to attract deposits from the banks during the period of the request. The authorities have made it clear that they hope not to use this procedure again. But it remains true that the banks pay heed to advice and observations of the Bank, which traditionally makes known the government's views as well as its own, since it is the traditional link between the government and the banking system.

Recommendations and directions to bankers under the Bank of England Act of 1946 have not been given so far and it remains to be seen whether use will be made of this power.

Action under the Exchange Control Act of 1947 is of decreasing importance. But the powers of the Treasury under that Act are very wide. Action is of course designed to protect the balance of payments, and the emphasis at present is on the control of capital movements to places outside the sterling area.

ANNEX

BANK OF

AN

for the week ended

ISSUE

Liabilities	£
Notes issued:	
1. In circulation	2,453,247,851
2. In Banking Department	47,112,089
Total . .	2,500,359,940

Dated the 27th day of December, 1962.

BANKING

Liabilities		£
8. Capital		14,553,000
9. Rest		3,551,485
10. Public deposits (including Exchequer, savings banks, Commissioners of National Debt and dividend accounts)		18,216,065
11. Other deposits:		
Bankers	£222,513,835	
Other accounts	£72,036,292	294,550,127
Total . .		330,870,677

Dated the 27th day of December, 1962.

ENGLAND

ACCOUNT

Wednesday, December 26, 1962

DEPARTMENT

Assets		£
3. Government debt		11,015,100
4. Other government securities		2,488,011,875
5. Other securities		710,851
6. Coin other than gold coin		262,174
Amount of fiduciary issue		2,500,000,000
7. Gold coin and bullion (at 250s. 2d. per fine ounce)		359,940
	Total	2,500,359,940

J. Q. HOLLOM, *Chief Cashier.*

DEPARTMENT

Assets		£
12. Government securities		224,558,393
13. Other securities:		
Discounts and advances	£38,855,478	58,339,049
Securities	£19,483,571	
		47,112,089
14. Notes		861,146
15. Coin		
	Total	330,870,677

J. Q. HOLLOM, *Chief Cashier.*

EXPLANATORY NOTE ON THE BANK RETURN

ISSUE DEPARTMENT

LIABILITIES

1. NOTES IN CIRCULATION

Comprises all notes in circulation with the public, including those in the tills of the banks and notes set aside as cover for the note issues of banks in Scotland and Northern Ireland to the extent to which those issues exceed prescribed limits.

ASSETS

3. GOVERNMENT DEBT

One of the original objects of the founders of the Bank was to lend money to the government, and at one time this debt was approximately equivalent to the amount of the Bank's capital; the debt has remained at the present figure for many years.

4. OTHER GOVERNMENT SECURITIES

Includes other obligations of the British Government, e.g. government and government-guaranteed loans quoted on the stock exchange, Treasury bills and Ways and Means advances.

5. OTHER SECURITIES

Consists of other securities of whatever nature.

6. COIN OTHER THAN GOLD COIN

A reserve of subsidiary United Kingdom coin (limited by statute to £5½ million) is held as a part of the fiduciary issue. (Notes to the total amount of the four headings immediately preceding comprise the fiduciary issue, the amount of which is regulated by statute.)

7. GOLD COIN AND BULLION

There is no statutory limit to the amount of notes which may be issued against gold; since the United Kingdom's gold reserves are now held by the Exchange Equalisation Account, the figure in the Bank return does not, in practice, vary other than with the weekly revaluation of the assets of the Issue Department.

BANKING DEPARTMENT

LIABILITIES

9. REST

Undistributed profits.

10. PUBLIC DEPOSITS

Already defined in the return.

11. OTHER DEPOSITS

Bankers: Comprises accounts of offices in the United Kingdom of deposit banks, accepting houses and discount houses.

Other accounts: Includes overseas central banks and monetary authorities for whom the Bank of England acts as a correspondent in London, and commercial and private customers.

ASSETS

12. GOVERNMENT SECURITIES

Includes obligations of the British Government, such as government loans quoted on the stock exchange, Ways and Means advances and Treasury bills.

13. OTHER SECURITIES

Discounts and advances: Includes bills, whether Treasury or commercial, acquired by discounting for customers, and in particular rediscounts for the discount houses. Also included are advances to the discount houses and to ordinary customers, the latter normally being relatively small.

Securities: Includes all other securities of whatever nature, including commercial bills purchased in the market.

SPECIAL DEPOSITS

These were held by the Bank from May 1960 to December 1962 and the amount outstanding was shown in the relevant Bank returns. (Special deposits are explained on pages 118–19.)

BANQUE DE FRANCE

I

ORIGINS AND LEGAL FRAMEWORK

FOUNDATION, NOTE-ISSUING PRIVILEGE

1. When the Bank of France first opened for business on February 20, 1800, its operations were confined to discounting, deposit business and the issuing of notes payable to bearer or promissory notes; it had no legal status or privileges. Even in the capital city itself there were several other institutions performing similar operations.

Three years later, under the law of 24th Germinal of the year XI (April 14, 1803), the Bank was granted its first official charter and a note-issuing monopoly in Paris. In its basic statutes, dated January 16, 1808, provision was made for the creation of discount offices 'in such towns in the *départements* where they are deemed to be necessary in the interests of business', and by the decree of September 8, 1810, the Bank was empowered to exercise its note-issuing privilege in these towns 'in the same way' as in Paris. Some forty years elapsed, however, before, as a result of the gradual elimination or absorption of the various institutions which issued notes payable to bearer, the privilege conferred upon the Bank became in effect a monopoly extending over the whole country. This situation was not legally ratified until 1936 (see Article 98 of the Codified Statutes).

In the meantime, the Bank's privilege, which was granted on a temporary basis for periods of varying length, was several times renewed by means of legislation. Under the law of December 20, 1918, it was due to expire on December 31, 1945, but in the law of December 2, 1945, nationalizing the Bank provision was made for it to continue indefinitely to be 'the sole institution responsible for issuing bank-notes in the entire metropolitan area' (Article 1, paragraph 2).

In addition to its Head Office, the Bank of France at present has 159 provincial branches (*succursales*), 3 Parisian branch offices (*bureaux de quartier*) and 97 sub-offices (*bureaux auxiliaires*).

CAPITAL

2. During the first half of the nineteenth century the Bank's capital,

which was initially fixed at 30 million francs[1] in 'metallic currency', was increased several times, in particular following upon the absorption of the banks of issue in the *départements*. Since then it has been raised twice, the first time, pursuant to the law of June 9, 1857, to 182,500,000 francs, and subsequently, by the decree of August 26, 1959,[2] approving a resolution, dated July 9, 1959, of the General Council of the Bank, to 15 milliard old francs, i.e. 150 million in terms of the new monetary unit. The latter increase was effected by means of an appropriation from the Bank's free reserves.

The capital is divided into 300,000 shares of a nominal value of F500 each; since January 1, 1946 (under the law of December 2, 1945, Article 1), these have been held by the state.[3]

The responsibility for determining the dividend to be paid on the shares rests, as it always has done, with the General Council.[4]

RELATIONS WITH THE STATE

3. Apart from transferring ownership of the shares to the state, the nationalization of the Bank has not affected its position in relation to the public authorities. There is no legislation providing for government intervention, in any form whatsoever, in the conduct of the Bank's business or empowering the government to issue general policy directives to be complied with by the Bank.

The absence of any such legislation has enabled the Bank to retain complete independence in its current day-to-day management. In effect, the very close relations that exist between the public authorities and the Bank are founded on tradition and involve constant

[1] In this chapter the term 'franc' designates both the monetary unit in circulation prior to January 1, 1960, and the new unit introduced on that date (see section 38), which is equal in value to 100 of the former units. To avoid confusion, however, the term 'old franc' has been used when the figures refer to dates close to the time of the changeover.

[2] Whereas until 1958 the Bank's statutes could be amended only by legislation, under Article 34 of the 1958 Constitution only the regulations concerning the currency issue now remain within the legislative sphere and other matters concerning the Bank are to be regulated by decrees issued after consulting the Council of State.

[3] The Bank's shareholders were compensated by the allotment of registered negotiable bonds of a nominal value of 7,000 old francs, bearing interest at 3 per cent and redeemable over twenty years by drawings. The interest is paid by the Bank and guaranteed by the Treasury; the latter is responsible for the redemption of the bonds.

[4] The General Council's powers in this matter are, however, subject to two limitations: 25 per cent of the profits resulting from the raising of the discount rate above the level of 5 per cent is placed to reserve and the remainder is paid to the Treasury; all the profits resulting from the raising of the rate for advances above the level of 6 per cent are placed to reserve (Articles 161 and 162 of the Codified Statutes).

contact between the Minister of Finance and the Governor of the Bank. Whenever matters of importance affecting the Bank's activity or requiring its intervention are concerned, no important decision is taken by the one without previous consultation with the other.

LEGAL STATUS

4. As the Bank's rôle and operations grew in scope, the basic statutes of 1808 were supplemented and amended by laws, decree-laws, conventions or treaties concluded between the Minister of Finance and the Bank and sanctioned by legislation.[1] This new legislation was merely additional to the basic statutes, the original wording of which remained unaltered. The Bank's charter was thus made up of a very complex structure of legal and statutory provisions, the most recent of which merely referred back to earlier legislation.

In order to put an end to this situation, a law was enacted on July 24, 1936, prescribing that all legislative and statutory provisions governing the Bank of France should be codified by decree. This codification is dated December 31, 1936, and incorporates the texts of 53 laws, decrees and conventions.

Since 1936, however, the former practice has been reverted to; the Codified Statutes have not been brought up to date,[2] although a large number of clauses have been explicitly amended or abrogated, have lapsed as a result of the adoption of new legislation, particularly the Nationalization Law, or are no longer operative.

To avoid undue detail in the sections relating to the Bank's organization and operations, the references will henceforth do no more than indicate the texts which should be consulted in each instance. The codification of 1936 will be referred to by the letters C.S. (Codified Statutes).

II

FUNCTIONS AND OBJECTIVES

5. The Bank of France, which at the outset was simply a Parisian discount, deposit and issuing bank, has only gradually and, in the main, over the last three decades become a 'central bank' in the present-day sense of the term. It has developed in this way without there ever having been any legal definition, in general terms, of its duties and objectives. In order, therefore, to list the main functions which now devolve upon the Bank, reference must be made to the

[1] Up to 1958. See footnote 2 on page 125.

[2] Article 3 of the law of December 2, 1945, provided for a revision of the Bank's statutes, but this has not yet taken place.

various legal and statutory provisions and the traditional practices which govern its activity:

(*a*) The Bank has the sole right to issue bank-notes in the entire metropolitan area. It is responsible for creating the necessary note reserves, maintaining the note circulation and regulating its volume and composition in accordance with the country's requirements. It also has to facilitate book transfers and settlements of funds.

(*b*) It is the banks' lender of last resort.

(*c*) It supervises the trend of bank credit and tries to adjust its overall volume to the needs of the economy and to ensure a sound and judicious distribution of short and medium-term credits. For this purpose it makes use of the powers which it is assigned by its statutes and those which it exercises on behalf of the National Credit Council. Its supervision in this field is supplemented by action in the money market with the same objects in view.

(*d*) Acting on behalf of the National Credit Council, it takes the decisions required to regulate the banking profession and banking practice and ensures their implementation.

(*e*) In its capacity as administrator of the Exchange Stabilization Fund for the Treasury it watches the gold and foreign exchange markets and intervenes, when necessary, to regulate the rates.

(*f*) It is the sole bank to handle cash in-payments and out-payments to and from the Treasury and transfers of Treasury funds. It also receives on behalf of the Treasury subscriptions to all types of government issues.

(*g*) It gives the government technical assistance in all matters falling within its competence. This co-operation takes place at all levels: the Governor is in constant touch with the Minister of Finance; the departments of the Bank have frequent dealings with the government departments concerned with economic and financial affairs and, where expedient, take part in their research work and other activities.

III

STRUCTURE AND ADMINISTRATION

ADMINISTRATIVE ORGANS

6. The administration of the Bank and its affairs comes under the authority of the Governor and the General Council (assisted by the

Discount Board). Before nationalization there was a General Meeting of shareholders with very limited powers, these consisting of:

hearing the report presented to it by the Governor on behalf of the General Council on the Bank's operations during the previous year, and also the report of the censors (*censeurs*) on their examination of the Bank's transactions (the term 'hear' excluded all discussion or voting rights);
electing the councillors and censors to represent the shareholders on the General Council.

GOVERNORS OF THE BANK[1]

7. The Bank's business is managed by a Governor with the assistance of two Deputy Governors, who perform the duties delegated to them by the Governor. The first Deputy Governor or, in his absence, the second Deputy Governor carries out the Governor's functions if the latter's post should be vacant, or if he is absent or sick.

The Governor and his two deputies are appointed for an indefinite period by a decree enacted by the Head of the State in Cabinet. The Governor is then sworn in by the President of the Republic. The posts of Governor and Deputy Governor are incompatible with parliamentary office. Holders of these posts are prohibited, as long as they are in office, from taking or accepting any interest or share whatsoever, whether in an active or in an advisory capacity, in any private enterprise of an industrial, commercial or financial nature.

8. The Governor attends to the execution, in all their ramifications, of the laws concerning the Bank, the statutes and the resolutions of the General Council, which must bear his signature before they become effective.

He presides over the General Council, which the Deputy Governors attend with the right to speak and to vote.

He alone signs, on behalf of the Bank, all treaties and conventions. Actions at law are brought in the name of the councillors and of the Governor, at the suit of the latter.

He appoints and dismisses the members of the Bank's staff.[2]

9. The Governor thus holds very wide powers as regards the management of the Bank. The three Governors do not constitute a board, nor is there a Board of Directors standing between the General Council and the Bank's administrative organs. This highly centralized system has existed unchanged since the Bank was founded.

[1] C.S., Articles 16–30; decree-law of July 30, 1937; law of September 3, 1940 decree of April 29, 1959.

[2] Subject to the exception indicated in section 18.

GENERAL COUNCIL[1]

10. Up to 1936 the members of the General Council other than the Governor and the Deputy Governors—consisting of fifteen regents (*régents*) and three censors—were appointed by the General Meeting of shareholders. The law of July 24, 1936, limited the number of members elected by the General Meeting to two councillors and the three censors, brought in one member elected by the personnel of the Bank by secret ballot and raised the total number of councillors to twenty.

Later, in 1940 and 1944, the total number, the composition and the method of appointment of members of the Council were modified. In 1945 the nationalization of the Bank reduced *de facto*[2] the number of councillors and of censors by two. From this legislation the following arrangement obtains at the present time:

In addition to the Governor and the Deputy Governors the Council consists of twelve councillors and two censors; the latter are not entitled to vote:[3]

(*a*) Four councillors are *ex officio* members; they are the General Manager of the Deposit and Consignment Office (Caisse des Dépôts et Consignations), the Governor of the Mortgage Loan Bank of France (Crédit Foncier de France), the President of the National Credit Bank (Crédit National) and the General Manager of the National Agricultural Credit Bank (Caisse Nationale de Crédit Agricole).

(*b*) One councillor is elected by secret ballot by the personnel of the Bank of France.

(*c*) Seven councillors are appointed by the Minister of Finance on proposals from the competent ministers:

two represent industry and commerce in metropolitan France;
four represent agriculture, labour, French interests in the overseas territories and French interests abroad respectively;
one represents general economic interests.

The councillors other than the *ex officio* members are appointed or elected for a term of four years, one-half retiring every two years; the retiring members are eligible for reappointment. Members of parliament may not be members of the Council.

The members of the Council other than the three Governors receive attendance fees fixed by the Council.

[1] C.S., Articles 44–64 and Article 99; law of November 24, 1940; ordinance of December 5, 1944; law of December 2, 1945.

[2] See section 4. [3] See section 29.

The Council meets at least once a week. No business can be validly discussed unless at least nine voting members and one censor[1] are present. Decisions are taken by an absolute majority of votes.

11. The Council 'supervises all parts of the Bank' and 'sees to it that the Bank does not conduct any operations other than those specified in the law and that they are carried out in accordance with the provisions of the statutes'. The Governor keeps the Council informed on all the Bank's activities.

The Council deliberates upon all 'general treaties and conventions', as also upon the establishment and closing-down of branches;[2] fixes the rates and general terms of discount operations and advances; decides upon the creation and issue of bank-notes, their withdrawal from circulation and their cancellation; prescribes the form of the notes and what signatures they must bear; deliberates upon the staff regulations[3] and the Bank's annual budget; fixes the remuneration of the Bank's staff, subject to the approval of the Minister of Finance; makes up the annual accounts; fixes the amounts to be allocated to reserves and the amount of the dividend;[4] and decides upon the investment of the reserve funds.

The law of July 24, 1936 (C.S., Article 63), had provided that the Council could delegate all or part of its powers to a standing committee composed of the Governor, the Deputy Governors and four councillors, but this provision was cancelled by the law of November 24, 1940.

DISCOUNT BOARD AND SPECIAL COMMITTEES[5]

12. The Discount Board (Conseil d'Escompte) consists of fifteen members, who must be actively engaged in commerce in Paris or hold the position of director, general manager or manager of a commercial company which has its head office in Paris or the Paris area.

They are appointed by the censors for a term of three years from a list of candidates presented by the General Council and containing three times as many names as there are vacancies to be filled. One-third retires each year, the retiring members being eligible for re-election. Members are entitled to attendance fees.

No member of the Discount Board may lend his services, either in an active or in an advisory capacity, or as a director, to a banking institution.

[1] Quorum established by the ordinance of December 5, 1944, for a total of seventeen voting members (including the three Governors), which was reduced to fifteen the following year after the nationalization of the Bank.

[2] See section 18. [3] See section 25. [4] See section 2.

[5] C.S., Articles 65–75; law of November 24, 1940; ordinance of April 13, 1945.

The members of the Discount Board, together with the councillors, act as members of the Discount Committee.

13. Nominated in an order of rotation drawn up by the General Council, the councillors and the members of the Discount Board forming the Discount Committee meet on every working day.

The Committee's function is, in principle, to examine the paper presented for discounting. In practice, it is given a report on the day-to-day development of discount operations, about which it may be consulted and on which it is free to comment.

14. The Supervisory Committee (Comité de Contrôle) is composed of councillors chosen by the General Council. It carries out periodic physical checks and audits, and reports on them to the Council.

HEAD OFFICE

15. The internal organization of the Head Office has become increasingly complex as the Bank's operations have developed and the tasks entrusted to the Bank have become more diversified. This development, which has been especially marked during the last few decades, has been reflected in an increase in the number of offices and in the combining of most of them into General Departments (Directions Générales).

At the moment the Head Office comprises nine General Departments and four offices or departments that are self-contained, i.e. directly responsible to the Governors.

The nine General Departments are:

the General Secretariat;
the General Supervisory Department (under which comes the Accounts Office);
the General Cashier's Department;
the General Discount Department (under which comes the Central Risks Office);
the General Securities Department (under which comes the Money-Market Office);
the General Research and Credit Department;
the General Foreign Department;
the General Personnel Department;
the General Note-Printing Department.

The four self-contained offices or departments are:

the Inspectorate;
the Legal Department;
the Organizational Office;

the Central Office, which corresponds to a branch establishment within the Head Office with the function of classifying and administering the many different kinds of private customers' accounts.

Finally, mention should be made of the following secretariats which, while not forming part of the Bank, are run by members of the Bank's staff:

the Secretariat of the Monetary Committee of the franc area;
the Secretariat of the Banking Control Commission;[1]
the Secretariat of the Stock Exchange Committee;[2]
the Secretariat of the Committee for Technical Research and Standardization of Banking Practice.

The names of most of these departments are sufficiently clear not to require any further comment. It would seem desirable, however, for some details to be given of the rather complex functions of two of the General Departments.

16. The General Research and Credit Department comprises:

(i) an office responsible for general documentation and for research into economic and monetary matters concerning both France and foreign countries;
(ii) an office specializing in the study of general credit matters[3] and in the formulation of decisions which rest either with the National Credit Council[4] or with the Bank itself;
(iii) an office called 'Banks and Financial Institutions' responsible for drawing up those measures relating to the regulation of the banking system which come within the province of the National Credit Council and for supervising the implementation of such measures when they have been adopted by the Council; and finally
(iv) the secretariat proper of the National Credit Council.

17. The General Foreign Department is responsible for:

(i) the management of the gold and foreign exchange holdings of the Bank and of the Exchange Stabilization Fund[5] and the conduct of relations with the Bank's correspondents in other countries and, especially, with the various international monetary and banking institutions;
(ii) the supervision of the gold and foreign exchange markets;

[1] See sections 121–129. [2] See sections 130–132.
[3] Examination of the paper presented to the Bank for discounting falls within the province of the General Discount Department.
[4] See sections 113–120. [5] See sections 46 *et seqq.*

(iii) the preparation and implementation, in conjunction with the Ministry of Finance, of payments agreements between France and other countries;
(iv) the granting of licences for the import and export of gold;
(v) certain other functions previously performed by the Foreign Exchange Office.[1]

BRANCHES[2]

18. The branches carry out the same transactions over the counter as the Head Office.

A branch cannot be established or closed down except by a decree adopted on the proposal of the General Council. Branch managers are appointed by ministerial order and selected from a list of three candidates submitted to the Minister of Finance by the Governor.[3]

19. The manager is assisted by from six to twelve councillors,[4] the number depending on the size of the branch, who are appointed by the Governor in consultation with the General Council. The councillors are chosen from among persons especially qualified by virtue of their experience of the commercial, industrial or agricultural activities of the area in which the branch operates (members of parliament and bankers are not eligible). They are appointed for a three-year term, one-third retiring annually. Like the members of the Discount Board of the Head Office, they are, in principle, 'called upon in rotation to examine and check samples of the bills presented at the branch for discount'. In practice, their main function at the present time is to keep the manager informed on the trend of economic activity in the area and on the position of firms established within the branch's sphere of operations.

One censor and one deputy censor, appointed for a three-year term by the General Council on the proposal of the Governor, perform in each branch the functions that in Paris devolve upon the Supervisory Committee.[5]

[1] See section 79. [2] C.S., Articles 76–90.

[3] This is the only case in which, formally at least, a member of the staff is not appointed by the Governor. When, in the middle of the last century, the Bank of France absorbed the provincial banks of issue, each branch was given a charter modelled on that of the Head Office (providing for a manager, a board of directors, a board of censors and capital of its own). As a consequence, branch managers were until 1940 appointed by decree (C.S., Article 81). In that year, however, a general law was passed which replaced the decree procedure by the 'order' (*arrêté*) procedure for all 'individual administrative acts'.

[4] These councillors were originally called directors (*administrateurs*) and formed a board of directors (see footnote 3 above); in 1936 these boards were abolished.

[5] See section 14.

20. Certain branches have attached to them one or more sub-offices, which are established under the same conditions and carry out the same transactions over the counter. Bills presented for discount are, however, referred to the branch.

21. In addition to the branches and sub-offices, Article 76 of the Codified Statutes mentions 'correspondent towns' (*villes rattachées*). Formerly these were localities in which the Bank had chosen a correspondent through whom it would collect bills held in its portfolio on the same terms as if it had itself been established there; the bills in question were deemed 'bankable'.

As a result of the growth of the banking system, the Bank has discarded an arrangement that had become pointless. In applying its terms for collecting bills it regards as a 'bank place' any locality which has a bank office open on every working day.[1]

22. The development of the Bank's branch network continued for almost a century. The object of the founders of the Bank was to 'regularize' credit and reduce its cost—a plan which, at a time when communications were slow and difficult, called for a country-wide system of branches. As, moreover, the public authorities wished to entrust the Bank with the task of effecting movements of Treasury funds, they made it open additional offices in return for the prolongation of its note-issuing privilege.

The gradual development of means of communication of all kinds, together with the expansion of multi-branch banking institutions (at the expense of the regional or local banks), did much to unify the terms of credit throughout the country, with the result that discountable paper was channelled towards the capital, where most of these institutions have their head offices.

Consequently, for several decades now the volume of credit operations handled by the Bank's branches has been steadily declining while that handled by the Head Office has been increasing, its customers, incidentally, being almost exclusively banks.

23. With regard to the credit operations that they continue to perform, the branches have only a limited freedom of action. Whether the business concerned is discounting, rediscounting or making advances against securities, maximum amounts have been set, beyond which any transaction must, depending on its nature and size, be approved or previously authorized by the Head Office, to which the relevant file must be submitted by the branch office.

24. From the point of view of running costs, the maintenance of the present branch network represents a charge on the Bank. Nevertheless, branches are still necessary for the maintenance of the note and coin circulation throughout the country and for the execution of

[1] At the end of 1962 there were 1,173 correspondent towns in this sense of the term.

cash operations for account of the Treasury and the other public administrations and of transfers of funds on behalf of banks and other holders of accounts at the Bank of France.

The branches also attend to the management of the clearing houses organized on the Bank's initiative, which group together banks, financial institutions (when cheques are drawn on the latter), the agricultural credit associations, the postal cheque offices and the local offices of the Treasury. The balances resulting from the daily clearing of cheques and drafts are passed to the accounts held by members of the clearing at the branch.

Finally, a widespread network of branches enables the Bank to obtain regularly, by way of managers' reports, first-hand information on the economic situation in the different parts of the country and on the trend of business in the various sectors of activity.

STAFF REGULATIONS[1]

25. The officials of the Bank, who must be of French nationality, are subject to special regulations deliberated upon in the General Council and approved by the Minister of Finance. The law of December 2, 1945, nationalizing the Bank stated specifically that no changes had been made in these regulations or in the manner of recruitment, dismissal or remuneration.

Since 1808 a reserve fund has been in operation, the administration of which has been laid down by decrees and which provides for the payment of pensions from the income accruing from the investment of its resources—comprising deductions from salaries, appropriations from the Bank's net profits, gifts and bequests—supplemented, up to the total amount of the pensions payable, by an annual contribution which figures in the Bank's budget.

PUBLICITY AND SUPERVISION OF OPERATIONS

WEEKLY RETURN[2]

26. Each week the Bank submits to the Minister of Finance a return which is published in the Official Gazette (*Journal Officiel*).

A specimen return, together with explanatory notes, will be found in the annex.

ANNUAL REPORT

27. The Bank's annual report, which since the nationalization of the Bank has customarily been submitted to the President of the

[1] C.S., Articles 91–94; law of December 2, 1945.
[2] C.S., Articles 153 and 189, paragraph 3; decree-law of September 1, 1939.

Republic, at the present time consists of three parts: a review of the general economic situation, a report on monetary developments and credit policy, and an analysis of the changes in the main items of the balance sheet. Annexes to the report give accounting and statistical data on the Bank's operations.

BOARD OF CENSORS[1]

28. Since the nationalization of the Bank the Board of Censors has been composed of two members, who are, traditionally, the Head (*Directeur*) of the Treasury Department and the Head of the External Finance Department. They receive attendance fees, the amount of which is fixed by the General Council.

29. The censors exercise general supervision over all the Bank's operations and may require to see all accounting documents.

They attend the meetings of the General Council and of the Supervisory Committee. At meetings of the General Council they have no right to vote but they may propose 'any measure that they consider to be beneficial to the conduct and interests of the Bank' and, if these proposals are not accepted, 'require that the matter be recorded in the minutes'. Any resolution of the General Council concerning the creation or issue of notes must, however, be approved by the censors. If they are unanimously opposed, the decision of the General Council is rendered null and void.

The censors appoint the members of the Discount Board.[2] Since the nationalization of the Bank the censors have presented a report every year to the President of the Republic on the supervision they have exercised.[3]

AUDIT COMMISSION FOR NATIONALIZED ENTERPRISES

30. Under the law of January 6, 1948 (Article 56 *et seqq.*), an Audit Commission (Commission de Vérification des Comptes) was set up for state establishments of an industrial or commercial nature and for nationalized enterprises. The Commission submits a separate report on each establishment or enterprise to the Minister concerned and an annual general report to Parliament, the Prime Minister and the Audit Office (Cour des Comptes).

As far as the Bank is concerned, however, the law of May 27, 1950 (Article 34), transferred to the Banking Control Commission[4] the powers which would normally be exercised by the appropriate section of the Audit Commission. The law provides that in this

[1] C.S., Articles 42–45, 49–51, 53–55, 58–62, 67 and 99; law of November 24, 1940; law of December 2, 1945.

[2] See section 12.

[3] This report is published at the end of the Bank's annual report.

[4] See sections 121–129.

particular instance the Governor of the Bank, who is *ex officio* President of the Control Commission, should not participate in its discussions but should be replaced by the President of the Financial Section of the Council of State (Conseil d'Etat).

LEGAL AND FISCAL STATUS[1]

31. As a general rule the Bank is subject to commercial law in so far as there is no express provision to the contrary in the laws and statutes pertaining to the Bank.

32. The oldest and most important derogation from this general rule is the provision which assigns to administrative jurisdiction competence with regard to:

(i) infringements of the laws and regulations governing the Bank and disputes in connection with its internal order and administration;
(ii) disputes between the Bank and members of its staff on points of civil law;
(iii) disagreements between the Bank and the Minister of Finance concerning amendments to the staff regulations that have been submitted to the latter for approval.[2]

For nearly a century and a half the only competent tribunal in such matters was the Council of State itself, against whose decision there was no appeal. A reform measure introduced in 1953, however, instituted as the court of first instance the administrative tribunals which sit in each *département*, while the Council of State, except in certain matters for which it continues to have sole competence, exercises jurisdiction only in cases of appeal or *cassation*.

33. Until recently the Bank was subject to special fiscal regulations, being liable to:

(*a*) a stamp tax on the yearly average of notes in circulation. This was calculated at two different rates: one for the 'profit-yielding circulation' (i.e. that part of the circulation representing the counterpart of operations on which the Bank receives discount charges or interest) and the other for the 'non-profit-yielding circulation' (i.e. the remainder). This tax was abolished in two stages, in 1938 and 1948.

[1] C.S., Articles 95–97; law of December 2, 1945, Article 3; decree of November 28, 1953; and C.S., Articles 158–159 and 164–166; decree-law of November 12, 1938; decree of December 9, 1948; law of May 24, 1951, Article 46.

[2] See section 25.

(*b*) a basic duty and a supplementary duty (the latter being progressive) calculated on the basis of the annual average of the profit-yielding circulation multiplied by the discount rate. These two duties were levied irrespective of the ordinary taxes payable by the Bank, as determined by the laws in force in 1917. Any increase in these taxes, however, and any new taxes subsequently introduced and payable on operations already subject to the said two duties were offset against the latter, only the balance, if any, being collected.

This complicated system was abolished in 1951 when, with retroactive effect from January 1, 1946,[1] the Bank was made subject to common law in fiscal matters. The law specified, however, that exemption from turnover tax should be accorded to Treasury payments to the Bank and to the revenue from rediscounting and *pension* operations (the taxes on the latter having already been levied when the bills were first negotiated).

IV

POWERS AND ACTIVITIES

NOTE-ISSUING PRIVILEGE[2]

34. The Bank has the sole right to issue bank-notes in the entire metropolitan area.[3]

35. The General Council takes all decisions concerning the issue and withdrawal of notes, with the single reservation that any resolution concerning the creation or issue of notes must be approved by the censors.[4]

LEGAL TENDER

36. The Bank's notes are everywhere accepted as legal tender. The lawful currency of a specific type of note may, at the Bank's request, be revoked by decree, but notes which have thus ceased to be legal

[1] This was the date of the Bank's nationalization. If the duty is regarded as a fee charged to a non-governmental institution in consideration of the right of issue granted to that institution, nationalization of the latter deprives the duty of its justification.

[2] C.S., Articles 98–105, 136–140, 145–147, 155–163 and 170–171; decree-law of September 1, 1939; ordinance of May 30, 1945; law of December 2, 1945, Article 1; law of January 30, 1948; law of December 6, 1954; ordinance of December 27, 1958.

[3] See section 1. [4] See sections 11 and 29.

tender continue indefinitely to be eligible for acceptance or exchange at the Bank's counters.

With the exception of the above-mentioned case, the lawful currency of the Bank's notes can be revoked only by legislation. This happened in 1945, when notes with a denomination of 50 old francs or more were withdrawn and replaced, and again in 1948, when the lawful currency and legal-tender force of notes of 5,000 old francs was abolished. On each occasion the Bank was expressly released from the obligation to refund such notes after a specified date.

By law the profit resulting from failure to present for refunding notes withdrawn from lawful circulation accrues to the state.

In practice, the Bank merely refrains from putting back into circulation the types of notes which it wishes to do away with gradually; such notes retain their legal-tender status. In the past the Treasury was paid the equivalent of the obsolete notes that had not been withdrawn only when legislation was passed to that effect. In such cases it was obliged to reimburse the Bank for any notes subsequently presented at the Bank's counters.

FORCED CURRENCY

37. Under the terms of the monetary law of June 25, 1928 (C.S., Articles 102–103), the Bank was bound:

(1) to convert its notes into gold on demand and to bearer; and
(2) to hold a stock of gold coin and bullion equal to at least 35 per cent of the aggregate total of notes in circulation payable to bearer and of balances on current credit accounts.

The first of these obligations was suspended by the monetary law of October 1, 1936 (C.S., Articles 170–171), which laid down that the conditions for the convertibility into gold of the Bank's notes should be determined by decree. The second obligation was suspended at the outset of the 1939–45 war by the decree-law of September 1, 1939. As no new legislation on the subject has since been enacted, the Bank's notes have been forced currency for a quarter of a century.[1]

FACE VALUE OF NOTES

38. The French monetary unit instituted by the ordinance of December 27, 1958, and introduced on January 1, 1960, was

[1] The historical background of 'legal tender' and 'forced currency' is as follows. They were both introduced for the first time during the short period between March 1848 and August 1850 and re-established on August 12, 1870, at the outbreak of the Franco-Prussian War. 'Legal tender' has been maintained since then without interruption, but 'forced currency' was discontinued on January 1, 1878, re-introduced on the outbreak of the 1914–18 war and abolished again by the monetary law of June 25, 1928.

provisionally designated by the term 'new franc' until December 31, 1962. As from January 1, 1963, it is designated by the term 'franc' and the abbreviation 'F'.

The note circulation comprises notes whose value is expressed in old francs, in new francs or in francs. The first category consists of notes of 500, 1,000, 5,000 and 10,000 old francs (the legal-tender force of which is equal to one-hundredth of their face value) and the second of notes of 5, 10, 50, 100 and 500 new francs; for the time being the third category consists only of the 50-franc notes issued since January 2, 1963.

OBLIGATIONS ASSUMED IN CONSIDERATION OF THE NOTE-ISSUING PRIVILEGE

39. The Bank had to take on a large number of obligations in return for the note-issuing privilege granted to it: in the past it had to pay the two special duties[1] and to make a permanent advance to the state;[2] nowadays it has, as already mentioned, to credit the Treasury with a sum representing the value of non-refunded notes of a type withdrawn from circulation and to put to reserve, or to pay to the Treasury, certain special profits.[3]

40. Similarly, the legislation prolonging the note-issuing privilege stipulated that a number of offices should be opened in the provinces.[4] The increase in the number of branches was designed to enable the Bank to fulfil various other obligations laid down in the same laws, namely:

(1) *vis-à-vis* the public: the collection of bills payable at bank places; the effecting, free of charge, of transfers in its own books between one place and another; the cashing of cheques drawn on bank places or on clearing banks (or their correspondents) and the domiciliation of bills at its offices, also free of charge;

(2) *vis-à-vis* the Treasury: the movement of funds, the encashment of cheques and bills and the execution of book transfers on behalf of the Treasury, both for account of the government and its dependent bodies and for account of communes and publicly-owned bodies. All these operations are effected without charge.

The Bank does not, however, act as Government Cashier;[5] the Treasury keeps its own accounts and has its own network of offices.

[1] See section 33.
[2] See section 69.
[3] See footnote 4 on page 125.
[4] See section 22.
[5] The question of assigning this rôle to the Bank was discussed in the past, but both parties concerned considered it preferable not to create any confusion between the government's credit and that of the Bank.

But its accountants may make payments or withdrawals at the Bank's branches or sub-offices to be credited or debited to the Treasury's current account, which is kept, free of charge, in the Head Office's books.

41. In the opposite direction, the Bank has agreed, since 1919, that each of its offices should be the holder of a postal cheque account, into which payments may be made to the credit of its customers.[1]

42. The Bank does not do the National Debt accounting.[2] It does, however, concurrently with the Treasury offices, pay, without charge, bearer coupons of *rentes* and Treasury paper which are presented at its counters. Moreover, it lends its services, free of charge, for the issue of the aforementioned securities and plays an important part in the placing thereof.

OPERATIONS OF A NATURE TO INCREASE THE NOTE ISSUE

43. 'The Bank may not in any circumstances or under any pretext whatever perform or undertake operations other than those which are authorized by law and by its statutes.' (C.S., Article 107, reproducing Article 8 of the basic statutes of 1808.)

Any operation or category of operations not provided for by law or by the statutes in force must, therefore, be sanctioned by legislation[3] before it may be undertaken.

44. The clause just quoted does not, on the other hand, mean that the Bank is obliged to undertake on request any operation that is in conformity with the legal and statutory regulations; it is under no such obligation unless this is expressly provided for by current legislation.[4] Except for the latter case, the Bank is always at liberty to withhold its co-operation, without giving grounds for its refusal, or to make its agreement subject to whatever conditions it deems appropriate.

45. Operations of a nature to increase the note issue comprise:

(1) gold and foreign exchange operations and advances to the Exchange Stabilization Fund;
(2) discount operations;
(3) advances against government paper and other securities;
(4) purchases and sales of government and private bills; and
(5) advances to the government.

[1] To prevent undisclosed advances, the balances on the Bank's postal cheque accounts are transferred weekly to the debit of the Treasury's current account.

[2] Since 1945 it has, however, kept the Treasury bill current accounts which were opened for the banks and financial institutions. (See section 77.)

[3] Article 34 of the 1958 Constitution retained in the field of legislation all matters concerning the currency issue. (See footnote 2 on page 125.)

[4] For examples see sections 46, 51 and 52.

GOLD AND FOREIGN EXCHANGE OPERATIONS, ADVANCES TO THE EXCHANGE STABILIZATION FUND[1]

46. Under the terms of the monetary law of 1928 (C.S., Article 110), the Bank was obliged to buy gold presented at the counters of its Head Office and of branches of its choosing at a rate fixed by law.[2]

The monetary law of October 1, 1936, which suspended the convertibility of the franc, also freed the Bank from this obligation; in theory, therefore, the Bank still had the option of buying gold over the counter.

The same law, amended by the decree-law of June 30, 1937, established the Exchange Stabilization Fund in the following terms:

> 'Until the enactment of the decree fixing the new gold content of the franc . . . an Exchange Stabilization Fund shall be established for the purpose of regulating the relationship between the franc and foreign currencies.
>
> The Exchange Stabilization Fund shall be managed by the Bank of France on the Treasury's behalf and on its responsibility. The Fund shall operate in accordance with decisions made by the Governor of the Bank of France within the framework of general directives received from the Minister of Finance.
>
> The Bank of France may buy from or sell to the Exchange Stabilization Fund gold and foreign currency.'

47. The Exchange Stabilization Fund's present charter was established by the Agreement of June 27, 1949, under the terms of which:

(1) the whole of the Fund's franc resources (previously deposited with the Treasury) are kept on current account at the Bank of France;[3] and

(2) the Fund's franc requirements are met by interest-free advances from the Bank. These advances are shown under a separate heading in the latter's weekly return.

48. Up to 1958 the Fund was less often short of national currency than of foreign exchange. Under the provisions of the 1936 monetary law, the Bank could have drawn on its holdings to supply any amount of gold required by the Fund provided the latter was in a position to make a cash payment in francs. As, however, the Bank was under no legal obligation in this

[1] C.S., Articles 109–111 and 172–174; law of March 10, 1937; decree-law of June 30, 1937; Agreement of June 27, 1949.

[2] The basic statutes of 1808 (C.S., Article 111) also permit the Bank to make advances to its customers against the deposit of ingots or foreign gold and silver coin. In point of fact, the Bank has not availed itself of this right since 1935.

[3] This current account is included under the sub-heading 'Current accounts of French banks and financial institutions' of the item 'Creditor accounts' in the weekly return.

respect, it preferred, every time that it was called upon by the Fund between 1940 and 1948, to make its co-operation subject to government intervention and the signing of an agreement ratified by legislation.

Since the implementation of the Agreement of June 27, 1949, the Bank has given assistance to the Fund on two occasions (1952 and 1957–59), each time, however, in the form of gold loans for a fixed term.[1] As this procedure was not provided for by law, these two operations were also the subject of agreements ratified by Parliament.

49. The Stabilization Fund is thus seen to be a set of debit and credit balances, in gold, foreign currencies and domestic currency, managed by the Bank. It is not a legal entity.

The Bank keeps the Fund's accounts. The balance sheet and the profit and loss account are drawn up every six months and communicated to the Minister of Finance, but they are not published. Profits and losses are passed to the account of the Treasury.[2]

The Bank has in fact never received any written instruction from the Minister of Finance regarding the management of the Fund. The department in charge of it is the General Foreign Department acting in conjunction with the competent departments of the Finance Ministry (the Treasury and External Finance Departments).

DISCOUNT OPERATIONS—LEGAL AND STATUTORY PROVISIONS[3]

50. The Bank discounts, for any member of the public, bills of exchange and other commercial paper with fixed maturities up to a maximum of three months drawn by traders or other persons of known solvency.

Bills presented for discount must bear the signatures of at least three persons known to be solvent.[4] The third signature may, however, be replaced by the pledging of securities eligible for acceptance as collateral for advances[5] or by the pledging of goods.[6] The Bank may also discount warrants bearing only two signatures.

Apart from these very general rules, the Codified Statutes contain two sets of provisions introduced in 1936 and supplemented or amended since.

[1] Both these loans were repaid before they fell due.

[2] The same applies to the Bank's profits and losses resulting from its transactions with the Fund.

[3] C.S., Articles 112–127, 175 and 176; decree-law of July 29, 1939, supplemented by the laws of July 30, 1940, and May 19, 1941; law of June 26, 1957.

[4] Additional guarantees may be required if the Bank has doubts regarding the meeting of the bill or wishes to check on the actual use of the credit to be granted.

[5] See section 61.

[6] These sureties may be furnished by a third party.

51. The first of these provisions is connected with the establishment of the National Wheat Office, later changed to the National Cereals Office (O.N.I.C.), and lays upon the Bank the obligation to assist in the financing of crops.

These operations are effected by the rediscounting at the National Agricultural Credit Bank or at banks (outside their rediscount ceilings) of bills issued by approved storage agencies—grain co-operatives and merchants—against the stocks they have built up and bearing the National Cereals Office's guarantee (*aval*).

Similar facilities are provided for the mobilization of certain stocks constituted on the basis of contracts endorsed by the National Cereals Office for the temporary holding of cereals for which it is difficult to find an immediate market.

52. The second provision introduced in 1936 was worded as follows (C.S., Article 122):

> 'All bills issued by the Treasury in respect of the floating debt and having a maximum of three months to run shall be accepted for rediscount without restriction, except for the benefit of the Treasury.'

This compulsory clause, which was designed to encourage and facilitate investments in Treasury paper, limited both the Bank's discretion as regards the total volume of bills it should accept for rediscount from any one presenter and its freedom of action on the money market.[1] Consequently, Article 122 was cancelled by the law of June 26, 1957, 'as far as Treasury bills held on current accounts are concerned',[2] i.e. Treasury bills held by banks and financial institutions.

53. In accordance with a provision dating back to the basic statutes of 1808, 'discounting is effected everywhere at the same rate unless some other ruling has been made on the special authorization of the government'. This provision, which goes back to a time when the main concern was to equalize the terms of credit throughout the whole territory, means that the same rate must be applied everywhere for transactions of the same kind, but not that the Bank is prohibited from varying its rates depending on the nature and the precise form of a transaction.

The General Council is responsible for fixing rates.[3] No legal provision limits the Bank's discretion in this important matter. Clearly, however, the Governor does not in practice propose to the Council any change in rates without first consulting the Minister of Finance.

54. In view of the traditional attachment of commerce to the use of the bill of exchange in the form of the *lettre de change*, discounting

[1] See sections 66–68 and 104–106. [2] See section 77. [3] See section 11.

remains in France the basic instrument whereby the banking system provides the economy with credit. The statutory provisions governing this fundamental operation are, however, extremely brief and for the last 160 years they have been modified or supplemented only on relatively minor points. They represent the Bank as an institution conducting discount operations direct with commerce, differing from other banks only by virtue of its right of issue.[1]

Such was, in fact, the rôle assigned to the Bank by its founders. In describing earlier[2] why the rôle of branches has declined in importance, an outline was given of the development which has taken place during the last decades and which, without any changes in legislation, has transformed the old bank of issue into a central bank confining in practice its discount credits to banks without, however, giving up its statutory privileges.[3]

The brevity and the very general nature of the statutory provisions have certainly facilitated this development. At the same time, however, it has been necessary to supplement them by instructions issued by the management of the Bank (some of which have required a prior decision of the General Council).

Statutory or customary provisions for discounting.

55. The presenter of a bill at the Bank does not have an absolute right to discount or rediscount facilities, even if the bill is of unquestionable quality.[4] The decision rests solely with the Bank, which does not have to justify it in any particular case.

56. Commercial paper, i.e. paper originating in the supplying of goods or the performance of services, clearly best meets the Bank's wishes as regards liquidity. This paper may, however, be for credit at inordinately long term, depending on the transaction that it represents. The Bank has thus had to lay down regulations regarding the currency period of commercial bills that it is willing to accept without prior approval; this term is generally fixed at ninety days, but is subject to certain variations on either side.

57. The Bank does not refuse to discount bills created in the normal way for purposes other than the supplying of goods or services, provided that they correspond to a money loan or to a

[1] The term 'rediscount' did not appear in the statutory legislation until 1936, when it was used with reference to the two special forms of assistance described in sections 51 and 52.

[2] See section 22.

[3] In practice the Bank reserves its direct discount facilities to its established customers and does not solicit any new ones. Thus, while around 1930 half of the Bank's bill portfolio consisted of bills discounted on behalf of non-bank customers, the proportion had dropped by the eve of the Second World War to about a quarter and fell to below 10 per cent after 1945 and to less than 1 per cent after 1954.

[4] Subject to the provisions referred to in sections 51 and 52.

line of credit. To be accepted, however, they must in general have received prior approval, which entails verification of the genuine and legitimate consideration of the bills.

58. The principle that the Bank must at any time meet calls for the redemption of notes has led the legislature to fix the maximum term for discounts at three months. At maturity the Bank is, however, free to grant a renewal for the same period of time.

In fact, the banks have for long been allowed to mobilize three to nine-month credits granted to persons engaged in agriculture, industry or commerce for the financing of their crops or their production or sales programmes. The bills representing these credits, however, never have a life of more than three months.

59. The arrangements for medium-term credits were more liberal. In the light of the vast amount of industrial reconstruction to be undertaken and the export drive that would have to be promoted after the end of the war, the General Council agreed in principle as from May 1944 to mobilize such credits and determined the conditions for such operations. After a number of modifications the main features of this scheme, which was extended in 1950 to the building of real property,[1] are as follows:

(*a*) If the banks concerned wish to avail themselves of the facilities for mobilizing credit, they must seek the prior approval of the Bank before granting such credit to their customers.

(*b*) The Bank may allow the bills created for the mobilization of the credit to be renewed, with or without a break, for three months at a time throughout the life of the credit.

(*c*) The maximum life of mobilizable credits is eighteen months, two years or five years, depending on the purpose for which the credit is granted.

The five-year currency period is only granted for credits designed to facilitate the development of an enterprise's productive equipment, the financing of certain export transactions guaranteed by the government or real property construction. For all credits in this category the bills must bear three signatures other than that of the

[1] The credits for real property construction are supplemented by long-term credits provided by the Mortgage Loan Bank of France. The latter credits expanded to such an extent, in fact, that they exceeded the resources available to this institution. In execution of the law of December 31, 1957 (Article 12), a Fund for the consolidation and mobilization of medium-term credits was set up which, deriving its resources from budgetary appropriations and various special provisions, grants advances to the Mortgage Loan Bank to the extent to which the latter is unable to borrow on the capital market all the funds it needs to consolidate medium-term loans as they expire. It also participates directly in the mobilization of outstanding medium-term credits, thus reducing the proportion of this financing effected by monetary means.

payee and are rediscounted only at public or semi-public credit institutions.

60. The opening of a discount current account (*compte-courant d'escompte*) usually involves the establishment of a maximum level or 'ceiling' for the commitments that the new transferor will be allowed to contract. In the case of a bank the ceiling had until 1948 no other purpose than to prevent the bank from having excessive recourse to rediscounting, account being taken of its importance and, above all, of the total of its own resources. No limit was fixed for the main banks, whose liquidity was ample and which had little, or only occasional, recourse to rediscounting.

Until recently, therefore, rediscount ceilings were not applied for reasons of monetary policy; the Bank influenced the total volume of credit solely through the classical device of the discount rate.

This has no longer been the case since the introduction, under the law of December 2, 1945, of the 'quantitative' measures of intervention described in sections 92 *et seqq.*

ADVANCES AGAINST GOVERNMENT PAPER AND OTHER SECURITIES[1]

61. The Bank may[2] make advances to any person against French Government securities and certain other securities issued by public or semi-public authorities and approved by the General Council. The latter determines the amount of such loans. The borrower enters into a twofold commitment *vis-à-vis* the Bank, viz.:

(i) to repay the sums borrowed on receipt of a formal request from the Bank transmitted by registered post; the loans are granted for a minimum period of five days and the Bank reserves the right to regard the loan as repayable at any time after the tenth day and to demand repayment;

(ii) to cover the Bank for any fall of more than 10 per cent in the market price of the securities lodged as collateral, the General Council reserving the right to decide how this clause shall be applied.

Should the borrower fail to fulfil one or other of these commitments, the Bank is empowered to sell all or part of the securities on the stock exchange without previously submitting the matter for adjudication, as follows:

(*a*) failing the required cover: three days after giving formal notice by an extrajudicial deed;

[1] C.S., Articles 128–134.

[2] As in the case of discounting, it reserves the right to consider each application on its merits and is free to accept or reject it.

(*b*) failing repayment: on the date fixed by the Bank without formal notice or any other formality.

The Bank uses the net proceeds of the sale to reimburse itself a sum equal to the principal amount of the advance plus interest and expenses. The balance, if any, is remitted to the borrower.

62. This exceptional procedure for selling the securities pledged, as well as the principle of limiting the period of the advances, reflects the Bank's wish to ensure the highest possible liquidity for its assets.

In practice, the loans at present take the form of current accounts which may be used for any banking operation. They may be either overdrafts up to the limit of the loan approved or credit accounts for an unlimited period so long as they are operating normally.

The interest rate, which is determined by the General Council,[1] is customarily higher than the discount rate.

63. The volume of advances against securities is steadily declining: their overall total now represents only a minute fraction of the Bank's assets as a whole.

The banks rarely take up advances against securities in the classic form just described. They prefer to have recourse to the more flexible and less costly advances at five to thirty days, which the Bank introduced for their benefit.

64. These originate in a decision taken by the General Council in 1935 that advances could be granted against government securities with a fixed maturity not exceeding two years at a different rate from the one generally applied to advances against securities, for a maximum period of thirty days and for an amount which could represent over 80 per cent but not more than 100 per cent of the current value of the paper on the day of the transaction.

Each advance is granted for a limited period: not less than five days and not more than thirty. Any advance granted for less than twenty-six days may be renewed once or several times for a minimum of five days until the limit of thirty days is reached.

Since 1948 the interest rate on these advances, which is determined by the General Council, may be lower than the discount rate. This has now been the case for several years.

65. Only banks and financial institutions can avail themselves of these advances. The Bank allocates each one a credit ceiling, the maximum overall total for transactions of this kind being fixed by the General Council.

This system provides the banks with additional liquidity facilities, which they use chiefly to meet their end-of-month commitments. Constant vigilance is required, however, if this system is to run

[1] See section 11.

smoothly, otherwise the advances granted under this procedure might, by reason of their attendant advantages, become a virtually permanent feature and thus unduly increase the rediscounting facilities available.

PURCHASES AND SALES OF SHORT-TERM GOVERNMENT AND PRIVATE SECURITIES[1]

66. The decree-law of June 17, 1938, authorized the Bank, 'with a view to influencing the volume of credit and regulating the money market',[2] to purchase, within the limits and on the conditions laid down by the General Council, short-term negotiable government paper and discountable private bills and to resell, without endorsement, such paper previously acquired. Such transactions might not in any circumstances be carried out for the benefit of the Treasury or the public authorities issuing such securities.[3] In the memorandum which gave the reasons for the decree-law it was stated that the aim was 'to grant the Bank greater freedom and more effective powers of intervention' and 'to increase the effectiveness of official discount policy'.[4]

67. The transactions in question concern Treasury bills with a maximum of two years to run, notes of the French Railways (S.N.C.F.), bankers' acceptances, paper unconditionally guaranteed by the National Office for the Financing of Government Purchases (Caisse Nationale des Marchés de l'Etat), mobilization paper guaranteed by a bank in respect of export sales and paper bearing the signature of the Mortgage Loan Bank of France. The five latter categories of paper must bear three signatures and have no more than ninety days to run to maturity.

In addition to outright purchases and sales, the Bank carries out *pension* operations in the categories of paper listed above, involving a purchase linked with a resale at very short term (a maximum of three months). The General Council has delegated to the Governor its powers to decide the rate for such operations. The overall balance of such operations must never exceed a maximum amount laid down by the General Council.

68. These transactions are open to the banks and to a few financial institutions that hold current accounts[5] with the Bank. To cover unforeseen requirements, they readily resort to the day-to-day or very

[1] Decree-law of June 17, 1938.

[2] This is the sole legal provision concerning the Bank which explicitly assigns to it an objective within the field of monetary policy.

[3] This restriction is similar to that laid down for the discounting of Treasury bills (see section 52).

[4] See sections 104–106.

[5] See section 74.

short-term *pension* facilities which the Bank is able to grant them straight away.

ADVANCES TO THE GOVERNMENT

(*a*) *The permanent advance.*[1]

69. The permanent advance to the government was initiated by the treaty of June 10, 1857, an agreement supplementing the law of June 9, 1857, by which the Bank's privilege was renewed. The advance was thus clearly in the nature of an obligation accepted in return for the privilege.[2]

The permanent advance originally took the form of a liquidity reserve, which was utilized as occasion demanded. Interest was payable only on the balance that remained after the offsetting against it of the Treasury's credit balances at both the Head Office and the branches of the Bank. In 1897 the advance became interest-free and was paid in full to the Treasury. It has been increased several times since to take into account the incidence of the growth of budget expenditure on the movements of Treasury funds and, after the 1914–18 war, the depreciation of the currency. After reaching 200 million francs in 1911, it was raised to 3,200 million in 1928, 10 milliard in 1938 and 50 milliard in 1947.

(*b*) *Temporary advances.*

70. In the nineteenth century the Bank frequently gave the Treasury temporary assistance, particularly in times of serious political stress. These credits were all repaid. The 1914–18 war was financed in part by direct advances from the Bank to the Treasury, all sanctioned by legislation, and further sums had to be advanced in 1925–26. Under an agreement dated June 23, 1928, the government repaid the Bank in full out of the accounting surplus derived from the revaluation of the gold and foreign exchange holdings on the basis of the new monetary parity. But the temporary advances account had to be reopened in June 1936 and from then onwards it was heavily drawn upon to meet the expenses resulting from the war and the occupation.

During the difficult period following the cessation of hostilities, the government was repeatedly forced to have recourse to the Bank. Its advances, granted under different names and by various procedures, were all the subject of agreements ratified by parliament and were all shown as separate items in the Bank's weekly return. As at December 31, 1959, these various advances totalled 914 milliard old francs, or more than 23 per cent of the Bank's assets.

[1] C.S., Article 135; Agreement of November 12, 1938; Agreement of March 27, 1947; Agreement of October 29, 1959. [2] See section 39.

71. In contrast to the temporary advances granted up to 1926, on which interest was payable, those extended from 1936 onwards were merely subject to an annual 'management commission' intended to cover the expenses incurred by the Bank in maintaining the additional note circulation necessitated by such advances. The commission ranged from 2 to 5 per mil, varying from time to time and from case to case.[1] In 1948 the basis on which the commission was calculated was changed and thereafter it consisted of the overall total of the non-profit-yielding circulation.[2] The rate, which was originally fixed at $2\frac{3}{4}$ per mil per annum, was gradually lowered to $1\frac{1}{4}$ per mil.

(*c*) *New accounting arrangements for the Bank of France's advances to the government.*[3]

72. In the interests of frankness and of keeping the public properly informed, the Bank used to include in its weekly return and in its balance sheet a detailed list of the advances successively granted. More recently, however, these details have been of no more than historical interest and have made the returns very cumbersome indeed: of the five advances included in the accounts at the end of 1959, four had been fully utilized and appeared as an invariable item, except for the periodical amortization payments mentioned below. Only the item of most recent date, 'Fixed-term advances', showed the changes in the Treasury's accounting position *vis-à-vis* the Bank.[4]

An agreement was therefore signed on October 29, 1959, stipulating that as from December 31, 1959, the various advances should be reclassified under the following two headings:

(1) 'Loans to the government', comprising three categories of advances that have been fully utilized (including, in particular, the former permanent advances), totalling 650 milliard old francs, i.e. 6·5 milliard in terms of the new monetary unit. This total was reduced to 5·45 milliard by the Agreement of May 3, 1962, as a counterpart to the transfer to the Exchange Stabilization Fund of responsibility for contributions to the International Monetary Fund previously assumed by the Treasury.

[1] This commission was extended in 1938 to cover that portion of the permanent advance over and above the level of 3,200 million previously obtaining.

[2] See section 33.

[3] Agreement of November 12, 1938; Agreement of June 26, 1957; Agreement of January 9, 1958; Agreement of October 29, 1959; Agreement of May 3, 1962.

[4] The movements of Treasury funds are debited or credited to its current credit account at the Head Office (see section 40). As, however, the Treasury has since 1914 (with the exception of the period 1928–36) had virtually interest-free drawing facilities at the Bank, it makes daily use of these facilities to balance its current account, which generally shows only a small credit balance.

(2) 'Advances to the government', combining the other two items, including, in particular, the 'Fixed-term advances'. This item had an initial ceiling of 500 milliard old francs, or 5 milliard in terms of the new monetary unit, and is the only one which varies from week to week.

73. In the past, special resources were earmarked under various agreements for the redemption of certain advances. Under the terms of the Agreement of October 29, 1959, these were reallocated as follows:

(*a*) funds earmarked for the redemption of 'Loans to the government':

(i) the proceeds of the liquidation of the Exchange Stabilization Fund and the cash balance of the Fund for supporting long-term government paper (Fonds de Soutien des Rentes); and

(ii) any profit accruing from a revaluation of the Bank's gold and foreign exchange holdings.

Any such amortization payments would reduce the present balance of 5·45 milliard by a corresponding amount. Should the amount outstanding be repaid in full, any remaining funds from the sources in question would be compulsorily applied to the amortization of the National Debt.

(*b*) funds earmarked for the repayment of 'Advances to the government':

(i) the profits made by the Exchange Stabilization Fund; and

(ii) the gross dividends of the Bank of France, which accrue to the government as sole shareholder.

These periodical repayments only temporarily affect the necessarily variable total of advances. Each time, however, the initial ceiling of 5 milliard is lowered accordingly.

OTHER OPERATIONS

CURRENT ACCOUNTS AND DEPOSIT ACCOUNTS[1]

74. The Bank receives on account sums paid to it by any person or corporate body.

There are two categories of account, both of which at present enjoy the same advantages and facilities with regard to transfers and payments,[2] viz.:

[1] C.S., Articles 141, 143 and 144. [2] See section 40.

(1) deposit accounts, opened in the name of legally competent persons upon verification of identity alone and in other cases after examination by the Legal Department; and

(2) current accounts, which may be either ordinary accounts or accounts with discount facilities. The attachment of sums deposited on current account is prohibited under the terms of a special provision dating back to the time of the foundation of the Bank. Consequently, before any such account is opened, the standing and solvency of the applicant are examined[1] and, if necessary, an opinion is sought from the Legal Department and the General Discount Department.

The Bank carries out all kinds of current banking transactions for its customers.

75. No interest is paid on current accounts or deposit accounts. To enable the Bank to provide some return on current accounts opened in its books for foreign central banks, it was authorized in 1928 to purchase short-term bills and securities on their behalf and to rediscount, at the request of the institutions concerned, those of the bills and securities in question in respect of which it is allowed to give its guarantee.

DEPOSITS OF GOLD, SILVER AND SECURITIES[2]

76. Under the terms of the basic statutes of 1808 the Bank has to 'maintain an office for receiving voluntary deposits of securities and of gold or silver bars or coins of any kind'.

The charges for safe custody are fixed by the General Council; a reduction of 25 per cent is allowed in the case of registered securities, annuities entered on current account in the public debt register and all other securities managed on current account by the Securities Clearing Association (Société Interprofessionnelle pour la Compensation des Valeurs Mobilières).

The Bank also lets out safes or safe compartments at its Head Office and in many of its branches.

TREASURY BILL CURRENT ACCOUNTS

77. Under an ordinance of April 13, 1945, and a supplemental decree of April 20, 1945, all banks and finance companies, stockbrokers (*agents de change*), stock exchange dealers (*courtiers en valeurs mobilières*) and their committees (*chambres syndicales*), special public funds and insurance companies are required to deposit their holdings of Treasury bills at the Bank of France.

The Bank opens in the name of each depositor a bill current

[1] In the branches the files are submitted to the councillors (see section 19) for a decision. [2] C.S., Articles 148–152.

account in which the various maturities are kept separately. It can allow institutions or persons other than those mentioned in the preceding paragraph to open bill current accounts (the French Railways (S.N.C.F.), among others, have taken advantage of this provision).

Entries on bill current accounts may be used for the same operations as the bills themselves, in particular for *pensions* and pledges. Changes of ownership merely entail a transfer from one account to another.

The Treasury has opened in its books a bill current account in the name of the Bank which records the overall figures of deposits and withdrawals, subscriptions and repayments of Treasury bills effected via current accounts held by the Bank.

REAL ESTATE TRANSACTIONS

78. Under the terms of the basic statutes of 1808 (C.S., Article 142) 'the Bank may, with the approval of the government, purchase, sell or exchange such real property as may be required for the carrying-out of its functions'.

The relative disbursements may, however, only be made out of the Bank's reserves. In practice, the Bank charges the necessary provisions to its profit and loss account each year.

MISCELLANEOUS FUNCTIONS

APPLICATION OF EXCHANGE CONTROL

79. Exchange control comes within the province of the Minister of Finance. The Bank, however, gives technical assistance in the preliminary work and in the drafting of statutory legislation.

Since 1939 the Bank has been entrusted with the issuing of gold import and export permits.

Under the decrees of December 21, 1959, which abolished the Foreign Exchange Office, responsibility for issuing permits of a financial nature was passed to the Bank, acting on behalf of the Minister of Finance and in accordance with his instructions. Certain departments of the Foreign Exchange Office (the Foreign Assets and Financial Supervision Departments and the Statistics Office, one of whose tasks it is to draw up the balance of payments) were attached to the Bank.

Subject to the approval of the Minister of Finance, the Bank may, if it deems this advisable, delegate to authorized intermediaries its power to issue permits.

All these functions are performed by the General Foreign Department.[1]

ASSISTANCE TO THE NATIONAL CREDIT COUNCIL[2]

80. Article 13 (paragraphs 12 and 13) of the law of December 2, 1945, lays down that the National Credit Council shall:

(1) 'perform, through the intermediary of the Bank of France, all the functions formerly entrusted to the Permanent Banking Committee, which shall be dissolved . . .'; this chiefly entails the drawing-up and application of technical and professional banking regulations;
(2) 'receive from all ministerial departments, the Banking Control Commission and the Bank of France all the documents it requires to fulfil its task'.

The duties and the work involved by these provisions are carried out by the General Research and Credit Department.[3]

CENTRAL RISKS OFFICE

81. In March 1946 the Bank of France, after the matter had been discussed by the National Credit Council, decided to make a periodic survey of bank risks and to centralize at its Head Office the data collected by its departments or branches, where there are 'local risks bureaux', each covering a particular district.

Banks and other financial institutions furnish the Bank each month with a statement of all credits granted to customers in excess of a specific sum (credits opened and credits utilized at the end of the month).

The centralization effected in Paris enables the Bank to ascertain the overall amounts of the credits opened and utilized by each borrower.[4] These overall amounts are communicated each month to those banks and financial institutions which have notified a credit in the name of a borrower, though they are not informed of the place or places where the credits have been opened or the banks concerned.

Banks and financial institutions which have not submitted a statement may receive notification of the risks attaching to one of their customers upon presentation of the latter's application for the opening or extension of a credit.

The Central Risks Office is attached to the General Discount Department.

[1] See section 17. [2] See sections 113–120. [3] See section 16.

[4] In fact, the Bank requires to be notified once a month, in respect of each borrower, of credit granted under six different headings. In addition, the banks must furnish twice yearly a statement containing six other headings.

82. In application of an ordinance dated January 7, 1959, the system of surveying, centralizing and notifying bank risks was extended to cover debts due in respect of social security contributions (the recovery of which is legally entitled to a preference). To this end the local risks bureaux are notified every quarter by the regional social security boards of debit balances in respect of contributions, when these balances exceed specific amounts.

CENTRAL RECORD OF UNPAID CHEQUES

83. Under the decree of May 20, 1955, any drawee who has refused payment of a cheque, in full or in part, owing to lack or insufficiency of funds is required to send the Bank an advice of non-payment within four working days.

On receipt of these notifications entries are made in a central card index of unpaid cheques kept by a department in the Bank attached to the General Secretariat, which can be consulted by banks (in particular before opening an account for a new customer).

V

MONETARY POLICY

84. After six years of inflation the French economy at the end of the war was in a highly liquid state, but the low level of business activity had impelled the banks to invest their liquid funds primarily in Treasury paper.[1]

The vast reconstruction effort to be undertaken made extensive recourse to credit inevitable. The government's own needs were such, however, that care had to be taken not to allow this effort to lead to a 'monetization' of the floating debt held by the banks. Consequently the government set out to regulate as far as possible the volume of the banks' liquid funds and to direct them to those uses that most accorded with the country's urgent needs. In the matter of credit this implied the application of both quantitative and selective controls.

85. The law of December 2, 1945, which nationalized the Bank of France and the four main credit institutions, placed the biggest *banques d'affaires* under the supervision of government commissioners and entrusted the National Credit Council with the task of regulating the banking profession and banking practice and of assisting in the formulation of credit policy, was designed to answer this dual purpose.

The composition, organization and main functions of the National Credit Council are set out in sections 113–120; they bring out the

[1] At the end of 1945 the portfolios of credit institutions consisted as to 70 per cent of short-term Treasury paper.

close interrelationship between this body and the Bank. The latter is both the research centre and executive agent for the Council, on whose behalf or with whose approval it issues statutory regulations or addresses directives to the banks. Far from detracting from the powers and authority of the Bank, the creation of the National Credit Council has enhanced them by reinforcing with new weapons the central bank's traditional armoury.

86. Within the framework thus outlined, the Bank's monetary policy has been and still remains essentially a rediscount policy. This is due firstly to the prime rôle that discounting has traditionally played in the distribution of credit,[1] and secondly to the fact that the effective reduction of the banks' resources brought about by the fall in the internal value of money forced them to have much greater recourse to rediscounting than formerly in order to be able to meet their customers' requests for accommodation without running down proportionately their investments in Treasury bills.[2]

The discount rate mechanism, even with the maximum possible use of differential rates, could not by itself have achieved the objectives defined above. Although the Bank has never at any time discarded this classical device, it has generally chosen to combine it with the application of direct measures designed either to encourage or discourage certain operations or to influence the overall volume of credit.

87. Mention will also be made of the Bank's intervention on the money market, which is of a complementary character, and also of the supervision it exercises over the gold and foreign exchange markets.

CREDIT POLICY

SELECTIVE CONTROLS

88. The instruments of selective credit policy have been created by the Bank.

The prior approval procedure[3] that has been in operation for some time requires the banks to submit to the scrutiny of the central bank any credits that they may wish to be able to mobilize by

[1] See section 54. At the end of 1962 four-fifths of the total of short-term credits made available by the banks took the form of the discounting of bills; whether these were bills drawn against a sale of merchandise or bills created for the purpose of mobilizing advances, the greater part fulfilled the eligibility requirements for rediscounting laid down by the Bank.

[2] At the end of 1958—when the money market was very tight—credits rediscounted by the banks amounted to no less than 34 per cent of the total of their credits outstanding.

[3] See sections 57 and 59.

rediscounting; the central bank is then free to apply to them whatever criteria it thinks fit.

Since the creation in March 1946 of the Central Risks Office[1] it has been possible by means of a systematic analysis, on the basis of a classification drawn up by the National Institute for Statistics and Economic Research, of the statements furnished by banks to ascertain the distribution of credits between the various economic sectors.

PRIOR AUTHORIZATIONS

89. Since 1947 the banks have, for any credit other than secured loans, guaranteed credits, documentary credits and credits in the form of the discounting of public bills, bills provided with a guarantee or an assurance of rediscount by a public or semi-public credit institution or purely commercial bills, been under an obligation to:

(1) require their clients to prepare a detailed file, which the Bank may ask to see, and
(2) obtain the prior authorization of the Bank before granting any credit that would bring the aggregate of bank loans granted to a single enterprise up to a certain level.

This level, fixed initially at 30 million old francs, was progressively raised to 1 milliard old francs (the figure in July 1959). Since October 1951, however, commercial bills have had to be taken into account in calculating the amount which may make a credit subject to prior authorization.

When granted, prior authorization does not, in itself, make an assurance of rediscount certain, but the grant of the latter is decisive for prior authorization, if such authorization is necessary in the case in question.

REGULATIONS IN RESPECT OF THE FINANCING OF HIRE-PURCHASE SALES

90. Special control is exercised over the financing of hire-purchase sales. On the one hand, banks and financial institutions may not finance credits of this type beyond a certain multiple of their own resources. On the other hand, the maximum life of the credits and the minimum down-payment to be made by the purchaser are regulated according to the kind of goods financed.

The precise form of these regulations has frequently been modified to take account of changes in the general economic situation or in the situation in the various economic sectors concerned.

[1] See section 81.

MISCELLANEOUS MEASURES

91. In the post-war years many recommendations or directives were issued to the banks with the aim of preventing speculative stock-building. They were renewed in a general form at the time of the bout of inflation in the summer of 1957.

On the other hand, export credits were encouraged by the maintenance of the rate of 3 per cent notwithstanding the rises in other rates, and by the extension to all claims on non-residents at not more than two years of mobilization facilities without reference to the rediscount ceiling.[1]

QUANTITATIVE CONTROLS

92. Since 1948 the National Credit Council and the Bank have considered it necessary to control the overall liquidity of the banking system. However, any general measure of credit restriction clearly carried the risk of inducing the banks to evade its effects by monetizing their large holdings of Treasury bills[2] and thus of increasing the difficulties facing the government.

'FLOORS' FOR TREASURY BILL HOLDINGS

93. To avoid this twofold risk, a directive was issued on September 30, 1948, instructing the banks to retain, as from October 1, 1948, at least 95 per cent of the portfolio of short-term government paper held by them on September 30th, and to invest in such paper 20 per cent of any increase in their sight and time deposits above the level obtaining at the same date. The amounts blocked in this way were commonly called 'floors' (*planchers*).

As the size of the banks' holdings of Treasury bills when the arrangement came into force varied, this requirement gave rise at first to fairly severe discriminatory effects, which were, however, gradually mitigated by the general growth of deposits. It consequently became possible, in July 1956, to abandon the reference to the base year 1948 and to fix the floors at a uniform 25 per cent of end-of-month liabilities. This proportion was reduced to 20 per cent with effect from January 31, 1961, at the same time as the liquidity ratio (*coefficient de trésorerie*)[3] came into effect, to 17·5 per cent as from June 30, 1961, and to 15 per cent as from March 31, 1962.

[1] See sections 94, 95 and 106. This category of credits was thus not affected by the general lowering of rediscount ceilings in 1957.

[2] This danger was not purely theoretical. To meet their customers' demands for accommodation, the banks had reduced their total holdings of short-term government paper from 234 to 178 milliard between the beginning of 1946 and the end of 1947.

[3] See section 97. In addition, the portion of liabilities that is counted only as to 50 per cent when the floor is calculated was raised from 2 to 4 million as from January 31, 1961, and from 4 to 10 million as from June 30, 1961.

REDISCOUNT CEILINGS

94. A further directive of September 30, 1948, assigned to all banks without exception a maximum level which their rediscounting commitments might not exceed and thus subjected commercial paper—until then eligible without limit for rediscounting—to a quantitative control. The extension to all banks of the system of rediscount ceilings—which in itself was not new[1]—had a specifically monetary purpose.

In fact, the ceilings fixed initially—totalling 185 milliard—had subsequently to be adjusted. This was done in the light of a more thorough examination of each bank's position and of the general economic situation, and following cancellation of the provision whereby the ceilings could be exceeded in the course of a month. Standing at nearly 500 milliard after the Korea crisis, they were raised to about 620 milliard at the time of the bout of inflation in the summer of 1957.

During the second half of that year the Bank made three successive reductions that brought down the overall level of the ceilings by 35 per cent, the main object being to offset the monetary effects of new advances granted to the Treasury. Subsequently the restrictions were eased in numerous individual cases.

DEPARTURES FROM THE SYSTEM OF CEILINGS

95. It proved necessary to adjust the system of ceilings in a number of ways in order to make it less rigid. These adjustments were in addition to the possibility of recourse—mentioned only incidentally because of the smallness of the amounts involved—to advances at five to thirty days against short-term government paper and to advances against securities proper.[2]

(1) The banks remain free to mobilize without reference to the ceilings bills representing medium-term credits[3] that have received the prior approval of the Bank and the specialized institutions (the National Credit Bank, the Mortgage Loan Bank and the Deposit and Consignment Office).

This constitutes an important departure from the system of ceilings, motivated by the desire to encourage investment.

(2) The banks may also rediscount without reference to the ceilings bills issued to finance the grain harvest which are guaranteed by the National Cereals Office[4] and, since July 1957, bills to mobilize export credits with a life of up to two years.[5]

[1] See section 60. [2] See sections 61-65. [3] See section 59.
[4] See section 51. [5] See section 106.

(3) The banks may, in principle, negotiate without limit Treasury bills at not more than three months that they hold over and above the obligatory floor.[1]

(4) They may have recourse to the short-term *pension* facilities which the Bank grants to the money market.[2]

(5) Finally, since 1951 banks have, as an exceptional and provisional measure, been able to obtain additional assistance not exceeding 10 per cent of their rediscount ceilings by means of temporary *pension* transactions in commercial bills at a rate higher than the discount rate. Since 1957 the Bank has consented to accept securities *en pension* beyond the 10 per cent limit but at an even higher penalty rate. Owing to their heavy cost,[3] the banks have recourse to these *pension* transactions only as a last resort.

THE STABILIZATION OF BANK CREDIT

96. The list of selective and quantitative measures implemented since 1945 would be incomplete without a mention of the directive addressed to the banks on February 7, 1958, requesting that the total amount of credits granted by individual banks (excluding medium-term credits granted to nationalized enterprises)[4] be kept within a certain limit, which was defined as the arithmetical mean of the totals on September 30 and December 31, 1957. A margin of 3 per cent was allowed, however, on condition that it was used for new export credits. (This represented a departure of a selective character from a measure which, by its nature and its objective, was quantitative.)

This measure, which had been taken to meet specific circumstances, was revoked in February 1959.

THE LIQUIDITY RATIO (*coefficient de trésorerie*)

97. The system of control which has just been described was not based on theoretical considerations; the measures adopted were taken to meet a situation characterized since 1945 by large-scale recourse to rediscounting by the banks.

The return to monetary stability brought about an inflow of foreign exchange which increased the volume of deposits and encouraged a resumption of savings. As the liquidity of the banking

[1] Subject to the reservation mentioned in section 52.

[2] See sections 66–68 and 105. [3] See sections 100 and 102.

[4] Upper limits were fixed directly for these credits and also for the medium-term credits granted by bodies other than the banks (building loans from the Mortgage Loan Bank and loans from the National Agricultural Credit Bank).

system improves, the effectiveness of the instruments of control outlined above is bound to decline.

In view of these circumstances, the National Credit Council decided in principle in October 1960 to introduce a new liquidity ratio, the so-called *coefficient de trésorerie*. This was to be fixed by the Bank and to make it possible to compel the banks to maintain a minimum ratio between certain items of their liquid or mobilizable assets on the one hand and the main components of their current liabilities on the other.

The favourable Treasury position, however, made it possible for the floors for Treasury bills to be lowered from 25 to 20 per cent as from January 31, 1961,[1] and this placed the banks in a position to switch funds from Treasury bills to paper which was more remunerative and which might be mobilizable at the central bank, thereby increasing their liquidity.

The Bank, therefore, with the agreement of the National Credit Council, decided in December 1960 also to put the liquidity ratio into force as from January 31, 1961, the precise form it should take having been settled in the meantime.

98. The following assets and current liabilities in French francs at the banks' head offices and branches in the metropolitan area are taken into account in calculating the ratio:

(1) Assets:
   (*a*) cash in hand and credit balances on account at the Treasury, postal cheque offices and the Bank;
   (*b*) Treasury bill holdings, minus the total of loans secured by such bills (but including bills constituting the compulsory minimum holdings, or floor);
   (*c*) commercial paper discounted, bought or held *en pension*, of the following types:
      (i) paper representing medium-term mobilizable credits,
      (ii) bills endorsed by the National Cereals Office, and
      (iii) bills created for the purpose of mobilizing claims on foreign countries.

(2) Liabilities: cheque accounts, current accounts, fixed-deposit receipts, fixed-term accounts and various credit accounts (minus certain temporary items). These current liabilities are the ones taken into account in determining the Treasury bill floors and the same deductions apply to them.

The categories of paper included among the assets are all, in theory, mobilizable without reference to a ceiling.[2] In practice,

[1] See section 93. [2] See section 95.

however, such paper is no longer accepted for rediscounting if the banks have to keep it in their portfolios in order to maintain the compulsory liquidity ratio. It is thus governed by conditions similar to those which have for some time now applied to commercial paper under the system of ceilings.[1]

99. The upper limit of the liquidity ratio is 35 per cent, while the lower limit is determined by the level of the Treasury bill floors.

The Bank is responsible for fixing the liquidity ratio within these two extremes: it set it at 30 per cent on January 31, 1961, and raised it to 32 per cent as from February 28, 1962.

INTEREST AND DISCOUNT RATE POLICY

100. In December 1962 the Bank was applying seven different rates of interest:

(i) the main discount rate (3½ per cent since October 6, 1960);
(ii) and (iii) the two discount rates for paper accepted *en pension* (one at 4½ per cent since October 6, 1960, and the other at 6 per cent since July 9, 1959);
(iv) the discount rate for bills for the mobilization of claims on foreign countries;
(v) the rate for purchases of Treasury bills at up to three months;
(vi) the rate for five to thirty-day advances against short-term government paper (the latter three rates have stood at 3 per cent since December 2, 1954); and
(vii) the rate for advances against securities (5 per cent since October 6, 1960).

101. The main discount rate, which was fixed at 3 per cent when the quantitative measures were introduced (in September 1948), was lowered to 2½ per cent in June 1950. This reduction reflected the improvement in the economic and monetary situation in 1949–50. The effects of the Korea crisis, however, led both to a stricter enforcement of the rediscount ceilings within any one month

[1] In a different context, the Banking Control Commission (see sections 121–129) fixed a liquid assets ratio (*rapport de liquidité*) with effect from February 1948. The deposit banks are required to maintain a ratio of at least 60 per cent between the total of their available, realizable assets and the sum of their short-term liabilities. This coefficient takes into account the banks' entire holdings of Treasury bills and rediscountable commercial paper, irrespective of any floors or ceilings, and thus acts as a safeguard to depositors in the matter of withdrawals.

The liquid assets ratio is not, therefore, an instrument of credit policy and should not be confused with the new *coefficient de trésorerie*. It does, however, indirectly facilitate control by the Bank by inducing the commercial banks to apply for rediscount facilities for their finance paper (so that they may include it when calculating the liquid assets ratio).

and to two increases in the rate, to 3 per cent and then to 4 per cent (in October and November 1951). It became possible to reduce the rate again to 3½ per cent in September 1953, then to 3¼ per cent in February 1954 and 3 per cent in December 1954.

The bout of inflation in 1957 brought a new series of increases—to 4 per cent in April and 5 per cent in August—while at the same time the rediscount ceilings were lowered by a very substantial amount.

The improvement in the situation made it possible a year later to adopt a policy of greater ease: the rate was lowered to 4½ per cent in October 1958, 4¼ per cent in February 1959, 4 per cent in April 1959 and 3½ per cent in October 1960.

In the course of twelve years, therefore, the discount rate was altered twelve times.

102. Designed as a means of penalization should the market situation tighten, the discount rates for securities *en pension* have shown much greater variations, the peak having been reached in 1958, when they stood at 8 and 12 per cent respectively.

In contrast, the discounting of bills for the mobilization of claims on foreign countries, purchases of short-term government securities, and five to thirty-day advances against short-term government paper have benefited from a rate of 3 per cent ever since December 1954.

Finally, the rates for advances against securities have during the past fifteen years followed a course similar to, but not identical with, that of the main discount rate. They have constantly remained above the latter, reaching a peak of 7 per cent during the period August 1957 to February 1959.

103. Among the duties which devolve upon the National Credit Council in organizational matters affecting the banking profession is, in particular, that of regulating banking terms and conditions. Here mention will be made of only one aspect of these duties which makes itself felt in the monetary field.

The Council determines, among other things, the minimum interest rates for credit operations. Until December 1959 these were fixed in relation to the Bank's discount rate, which was regarded as the sole basic rate. Since then, the basic rate (in addition to which there are, as before, certain other variable or fixed conditions to be taken into account) has been equal to:

(i) the official rate, as long as the latter remains between 3½ and 4½ per cent;
(ii) 3½ per cent minus half the difference between 3½ per cent and the official rate, if the latter is less than 3½ per cent;
(iii) 4½ per cent plus half the difference between 4½ per cent and the official rate, if the latter is more than 4½ per cent.

Consequently, when money is dear, the banks find their margin of profit diminishing if they are forced to resort to discounting and they are thus led, more than used to be the case in the past, to curtail their lending to the economy. On the other hand, when money is cheap, it is more in their interests than it used to be for them to expand their operations. This system, therefore, is of a nature to impart greater effectiveness than in the past to changes in the discount rates.

INTERVENTION ON THE MONEY MARKET[1]

104. Having been obliged since 1945 to make permanent use of the Bank's rediscounting facilities, the banks have not had sufficient funds to keep the money market amply supplied. But even in the pre-war years, when the credit institutions enjoyed an abundance of liquidity, they preferred to concentrate mainly on direct discounting.

The narrowness of the French money market is intensified by three other factors:

(i) French banks have always refrained from investing funds received from the public in long-term securities; the fact that deposit banks have been prohibited since 1945 from accepting funds for periods exceeding two years has reinforced their traditional prudence in this respect. For its part, in accordance with its general policy designed to give appropriate flexibility to interest rates and to the liquidity of the economy, the Bank neither purchases nor sells medium or long-term public-debt paper. The decree-law of June 17, 1938, authorizes it to intervene only by the purchase and sale of 'short-term negotiable government paper' and 'discountable private bills', and then only 'with a view to influencing the volume of credit and regularizing the money market'.

(ii) The present bank regulations have the effect of denying the public access to the money market, since the banks are not at liberty to borrow from or lend to their customers at freely negotiated rates.

(iii) The obligation to preserve a minimum holding of Treasury bills[2] means that the bills concerned are not freely disposable and tends to tighten the banks' liquidity position.

If the banks have ample liquidity, the rate offered for Treasury bills does not, as a rule, make it worth their while to purchase Treasury bills beyond the prescribed floor. They prefer to lend at very short term to the extent of their surplus funds and, when the money-market rates are higher than the official discount rate, within the limits of the rediscount facilities available to them at the Bank.

Other operators on the market, apart from the banks, are a certain

[1] See sections 66–68. [2] See section 93.

number of public and semi-public institutions with a large volume of funds to manage, such as the National Credit Bank, the National Agricultural Credit Bank, the French Railways and, above all, the Deposit and Consignment Office. These are the main providers of funds for the market in short-term government paper.

105. Money-market operations include outright purchases and sales of Treasury bills and *pension* operations in respect of Treasury bills and commercial bills. The shortest *pension* operations are on a day-to-day basis and the longest at three months.

With a view to ensuring a certain degree of flexibility in the banks' liquidity position, the Bank intervenes, if it considers it advisable. either by buying Treasury bills or by granting day-to-day, or very short-term, *pension* facilities against Treasury bills or certain other types of bill with negligible risk, such as bankers' acceptances, bills guaranteed unconditionally by the National Office for the Financing of Government Purchases and notes issued by the French Railways, mobilization paper guaranteed by a bank in respect of export sales, and paper bearing the signature of the Mortgage Loan Bank of France. Constantly informed of the fluctuations in the banks' liquidity position, the Bank operates through the *maisons de réescompte*, which, on a smaller scale, are comparable to the British discount houses.

106. The securities purchased or accepted *en pension* are shown in the item 'Negotiable bills purchased in France' in the Bank's balance sheet. However, a comparison of the balance of this item and that of the 'Bills discounted' account does not give a completely accurate idea of the relative magnitudes of these two types of operation. For accounting reasons the item 'Negotiable bills' includes two groups of securities that are, in fact, discounted without reference to the ceiling and have the benefit of a reduced rate.[1] These are:

(i) Treasury bills with a maximum currency period of three months (for this reason, the item 'Bills discounted' has since 1948 not contained any Treasury bills);
(ii) bills for the mobilization of claims on foreign countries at up to two years.

SUPERVISION OF THE GOLD AND FOREIGN EXCHANGE MARKETS

GOLD MARKET

107. In the years preceding the last war, apart from a short break of six months from October 1936 to March 1937,[2] gold transactions were completely free.

[1] See sections 100 and 102.

[2] The monetary law of October 1, 1936 (C.S., Article 173), introduced a very strict control, which was removed by the law of March 10, 1937.

The exchange control introduced at the outbreak of hostilities prohibited the purchase and sale and the import and export of gold without the special authorization of the Bank. In effect, permission to buy and sell gold was granted only to persons using gold professionally as a raw material.

At the beginning of 1948 the public authorities came to the conclusion that the best way of combating the excesses and abuses of hoarding that had developed in the wake of the post-war inflation was to make domestic gold transactions free again. This was the object of Article 2 of the law of February 2, 1948, under the terms of which 'the holding of, transport of, and trading in, gold are free on French territory' (the import and export of gold remaining subject to the Bank's approval).

The restoration of free dealings in gold had the effect of doing away with the 'secrecy premium' that had influenced the black-market rates for gold bars and coins. The fact that anyone was able to buy and sell gold freely was tantamount to establishing a sort of internal convertibility of the franc against gold at rates fluctuating from day to day. A downward trend of these rates and a decline in the volume of transactions were only expected to occur in the long run by reason of the strengthening of the economy and of the currency.

108. The instrument for this policy was the official gold market,[1] opened in Paris under the joint control of the stock exchange committee and the Bank, to which representatives of the stockbrokers and of the institutions and houses (in particular, approved intermediaries) admitted by the stock exchange committee have access.

Responsible for the technical supervision of the market, the Bank, acting on behalf of the Exchange Stabilization Fund,[2] does not obstruct the free formation of market rates. It limits its intervention as far as possible to eliminating excessive swings in either direction, without attempting to alter the trend of the market. Taking advantage of the disparity in the premiums in relation to the official values the Bank has often been a seller of gold coins and a purchaser of gold bars.

The extent of the Bank's intervention has become more and more limited during the last few years.

FOREIGN EXCHANGE MARKET

109. Under the system of strict foreign exchange control and bilateral agreements that characterized the early post-war period, the Bank acted on behalf of the Exchange Stabilization Fund as counter-

[1] No such market existed in the past: before the war transactions in gold were carried out directly between specialist institutions and buyers or sellers.

[2] See section 46.

part in respect of all orders for the purchase and sale of foreign exchange transmitted to it by approved brokers. It endeavoured, however, in agreement with the Ministry of Finance, to re-establish as soon as possible a foreign exchange market in so far as existing controls and payments agreements permitted. From January 1948 onwards it was possible to quote the dollar on a market on which brokers' buying and selling orders were offset, the Bank intervening only in respect of the balance, at the rates that it considered it desirable to maintain.

One by one, other currencies were introduced onto the foreign exchange market, the Bank intervening, however, automatically at the buying and selling rates resulting from the agreements in force. Since July 1950 the market has included all currencies quoted in France.

110. In the situation created by the monetary reform of December 1958 and the consequent declaration of the new parity of the franc to the International Monetary Fund, the main task of the Bank in the foreign exchange market is to ensure that the margins of fluctuation in the rates permitted under the articles of the International Monetary Fund and of the European Monetary Agreement are respected. This reform did not, however, entail any technical change as regards the functioning of a market which had long beforehand been conceived with a view to a gradual return to freedom of transactions.

The restoration of external convertibility and the easing of the exchange regulations in other ways led to a substantial increase in the volume of operations handled on the Paris market, in particular with foreign countries.

111. Apart from its regulatory function, the Bank intervenes on the market to execute the orders of its clients, i.e. essentially the Treasury and the various public administrations and autonomous government bodies.

112. For forward operations, as for spot operations, the Bank was obliged during an initial phase to act as counterpart in respect of all transactions authorized. As soon as the foreign exchange market was re-established, it sought to promote direct dealing in forward exchange between intermediaries—a practice which had been abandoned ten years before—and was fairly soon able to bring its intervention to an end. Its consistent policy since then has been to keep off the forward market, on which equilibrium is brought about by the free play of the rates.

NOTE ON THE NATIONAL CREDIT COUNCIL

113. The creation, composition, operation and functions of the National Credit Council are based on Section V, 'The Control of Credit', of the law of December 2, 1945, regarding the nationalization of the Bank of France and the large banks and the organization of credit, together with subsequent amendments thereto.

COMPOSITION

114. The President of the National Credit Council is the Minister of Finance and Economic Affairs, 'who may delegate his powers to the Governor of the Bank of France, the *ex officio* Vice-President of the Council' (Article 12).

In fact, the Minister very rarely presides over the Council in person. Usually its deliberations and business are conducted under the chairmanship of the Governor of the Bank.

115. In addition to the President and Vice-President, the Council consists of forty-three members, selected as follows:

(*a*) eleven are appointed by the Minister of Finance and Economic Affairs on the grounds of their importance in the country's economic life;
(*b*) eight are proposed by the leading trade union organizations, four of these being appointed by the Minister of Finance and Economic Affairs and four by the Minister of Labour;
(*c*) eight represent various public administrations;
(*d*) eight are appointed by the Minister of Finance and Economic Affairs on the grounds of their special knowledge in the financial or banking fields (three of these being representatives of the nationalized deposit banks); and
(*e*) eight are or have been on the management of a public or semi-public credit institution.

The Head of the Treasury Department attends all the meetings of the Council and of the committees set up from among its members.

OPERATION

116. The Council:

(1) in principle holds a plenary session once a month;
(2) has set up from among its members a number of special committees and delegated to one of them, the Banks and Financial Institutions Committee, the power to take any

decisions of an individual character concerning the regulation of the banking profession, these being submitted to the Council only if they have not received the unanimous support of the Committee; it is now accepted that the requirement that the Council shall meet once a month is fulfilled either by a meeting of this committee or by a plenary session; and

(3) submits in the first quarter of each year a report to the Minister of Finance and Economic Affairs on the credit situation and related problems.

FUNCTIONS

117. The Council's functions are laid down in Article 13 of the law. A large number of them, which were bound up with the economic situation in the immediate post-war period, are only of historical interest today.

In effect, the main functions of the Council at the present time are:

(1) to regulate the banking profession and banking practice;
(2) to assist in the formulation of credit policy.

118. With regard to the first of these functions, the laws of June 13 and 14, 1941, had set up a corporate body under the direction of a Permanent Banking Committee, the members of the Committee, all professional bankers, being appointed by the Minister of Finance. The law of December 2, 1945, dissolved that Committee and transferred all its functions to the National Credit Council, laying down that the latter would perform these 'through the intermediary of the Bank of France' (Article 13, paragraph 12).

To regulate questions relating to the banking profession and banking practice, the Council takes 'decisions of a general character' which come into effect immediately, provided they have been approved by the professional association concerned. If not, i.e. if the professional association has not given its approval or has not been consulted, the decision requires the approval of the Minister of Finance and Economic Affairs before it becomes operative.

Decisions of a general character are subject to appeal to administrative jurisdiction if regarded as being *ultra vires*.

The application of the general regulations to particular institutions gives rise to 'decisions of an individual character' (on such matters as the entry and classification of institutions in and their removal from the register of banks, bank mergers, and the opening and closing of offices). Appeal against such decisions can be made to the Banking Control Commission.

119. As regards its second main function, which is of major importance, the Council's powers are less clearly defined. Strictly according to the letter of Article 13 of the law, its powers are purely advisory in respect of matters falling within the province of the legislative or executive authorities, even in cases in which it is acknowledged, explicitly or implicitly, that the Council can take the initiative in giving its opinion. Thus, paragraph 9 requires the Council to 'give advice on all directives concerning the distribution of credit', without specifying from whom the directives are to emanate.

However, any measure tending to influence the distribution of credit, whether it is a selective or general measure, entails the issuing of technical instructions, statutory power for which has been vested by law in the Council. This has indirectly provided it ever since its creation with the means of carrying out—in close conjunction with the Bank, the Governor of which is *ex officio* Vice-President and *de facto* President of the Council—its task of guiding and controlling credit.

CO-OPERATION BETWEEN THE BANK AND THE NATIONAL CREDIT COUNCIL

120. In its relations with the Bank the Council is, as it were, the legislative body and the Bank the executive body. The latter draws up decisions of a general character for submission to the Council. When these have been adopted, the Bank issues them 'acting on behalf of the Council', clarifies if necessary the details of application by means of instructions to the banks and supervises their implementation.[1]

Under the terms of paragraph 9 of Article 13 referred to above, the Governor may consult the full Council on any directive relating to the distribution of credit. He must then, in his capacity as Vice-President of the Council, write to the President of the Bankers' Association on the subject.

NOTE ON THE BANKING CONTROL COMMISSION

121. Under the legislation enacted in 1941,[2] the Banking Control Commission was given a supervisory function and a number of regulatory, disciplinary and administrative powers. The law of December 2, 1945, and subsequent legislation have modified its original composition and widened its powers and functions.

[1] See sections 16 and 80. [2] See section 118.

COMPOSITION

122. The Commission normally consists of five permanent members (or their alternates appointed by the Minister of Finance):

(1) the Governor of the Bank, who is *ex officio* President of the Commission;
(2) the President of the Financial Section of the Council of State;
(3) the Head of the Treasury Department;
(4) a representative of the commercial banks appointed by the Minister of Finance on the nomination of the Bankers' Association;[1]
(5) a bank staff representative appointed by the Minister of Finance on the nomination of the leading trade union organizations.

Decisions are taken by a majority vote, the President having the casting vote. Reasons for the decisions must be given and the decisions are communicated to the National Credit Council.

FUNCTIONS

1. SUPERVISORY FUNCTION

123. The Commission discharges its assigned task of supervising the implementation of the bank regulations mainly by examining the periodical documents sent to it—in particular the quarterly returns (or monthly returns in the case of the largest banks), the balance sheets and the profit and loss accounts—and by asking the banks for any explanatory statements, evidence or further information that it deems necessary.

In addition, it may have examinations carried out on the spot by the Bank's inspectors.

2. REGULATORY POWERS

124. The Commission issues instructions to the institutions under its supervision to inform them of the accounting regulations by which they must abide.

Since 1946 it has had authority, if a proposal is made by the Bank, to lay down or alter, when necessary, the rules that deposit banks must observe in the conduct of their business, so that they maintain a sufficient degree of liquidity and do not endanger their solvency.

[1] When matters concerning financial institutions are on the agenda, the meetings are also attended by a representative of these institutions, who is appointed by the Minister of Finance on the proposal of the Association of Financial Institutions and Establishments.

These rules are embodied in five ratios, of which only one—the liquid assets ratio—has so far been fixed.[1]

3. DISCIPLINARY POWERS

125. In the event of infringement of the bank regulations, the Commission may impose sanctions on banks and financial institutions ranging from a mere warning to removal from the register.

Appeals against the Commission's disciplinary decisions can only be made to the Council of State.

4. POWERS IN RESPECT OF ADMINISTRATIVE APPEALS

126. Acting in its administrative capacity, the Commission gives a ruling on appeals lodged against the decisions of an individual character taken by the National Credit Council.[2] Appeals against the decisions of the Control Commission can only be made under administrative jurisdiction.

5. APPROVAL OF THE ACCOUNTS OF THE NATIONALIZED DEPOSIT BANKS

127. With regard to the four nationalized credit institutions, the Commission exercises the powers previously held by the General Meeting of shareholders. In this instance it is joined by three members of the National Credit Council elected by the Council, and the representative of the banks is replaced by the President of the section of the Audit Commission for nationalized enterprises which is responsible for credit matters.

6. EXERCISE OF POWERS NORMALLY VESTED IN THE SECTION OF THE AUDIT COMMISSION FOR NATIONALIZED ENTERPRISES WHICH IS RESPONSIBLE FOR CREDIT MATTERS

128. Since 1950 the Commission has been entrusted, as far as the Bank[3] and the four nationalized credit institutions are concerned, with the powers usually exercised by the section of the Audit Commission for nationalized enterprises that is responsible for credit matters. In this instance its composition is the same as that described in the preceding paragraph except that, for the examination of the Bank's accounts, the Governor does not take part in the Commission's deliberations, his place being taken by the President of the Financial Section of the Council of State.

[1] See footnote 1 on page 163. [2] See section 118. [3] See section 30.

7. OTHER POWERS

129. The Commission is empowered:

(*a*) to propose changes in or additions to the bank regulations;
(*b*) to take legal action against institutions that infringe the bank regulations but are not subject to its disciplinary powers;
(*c*) to appoint, independently of any disciplinary action, a temporary administrator in the event of default on the part of the management of a bank or financial institution;
(*d*) to appoint a liquidator for institutions whose names have been removed from the approved list or which have been de-registered or which have not been listed or registered and have been instructed to close down within a given time.

NOTE ON THE STOCK EXCHANGE COMMITTEE

130. The regulation of issues of stocks and shares falls within the competence of the Ministry of Finance (Treasury Department) and the Bank does not have to act directly in this field.

The Governor or a Deputy Governor of the Bank is, however, the *ex officio* Chairman of the Stock Exchange Committee created under the law of February 14, 1942, whose secretariat is provided by the Bank. In connection with the reform of the capital market the Finance Act of July 29, 1961, and a decree of October 30, 1961, broadened the composition and powers of this Committee, conferring upon it, in particular, wide regulatory powers.

COMPOSITION

131. Apart from the Chairman the Committee has since January 1, 1962, consisted of:

(1) the President (*Syndic*) of the Stockbrokers' Association (*Compagnie des agents de change*) of the Paris Stock Exchange, who is *ex officio* Vice-Chairman; and
(2) seven members appointed by the Minister of Finance:

(*a*) the President of a stock exchange other than the Paris Stock Exchange;
(*b*) a member of the Paris Stock Exchange;
(*c*) two representatives of the banks or financial institutions;[1]

[1] When questions directly concerning half-commission men and portfolio managers are discussed, a representative of those professions appointed by the Minister of Finance may also attend the meetings of the Committee in an advisory capacity.

(*d*) two representatives of investment institutions or of French bondholders and shareholders; and
(*e*) a representative of the staff of the Paris Stockbrokers' Association.

The Head of the Treasury Department performs the functions of Government Commissioner.

FUNCTIONS

132. (1) The Committee is empowered to take decisions on any question of a general character concerning the operation of the stock exchanges; in particular it fixes the rate and composition of cover in respect of forward commitments.

Subject to the provisions of the law of May 13, 1916, as amended, concerning the listing of foreign securities on the stock exchange,[1] the Committee decides, after consulting the individual stockbrokers' board or boards concerned, on the listing of securities on an exchange and the striking-off of securities previously listed.

It also takes decisions of an individual character on matters expressly reserved to it by law or by the regulations.

(2) The Chairman of the Stock Exchange Committee may, either on his own initiative or at the request of the Minister of Finance, ask the inspectorate of the Paris stockbrokers' board or the Bank's inspectors to conduct any enquiry in order to ensure that the Committee's decisions are acted upon.

(3) The internal regulations of the stockbrokers' associations are submitted to the Committee for its approval.

(4) The Committee has to give its views on numerous matters specified in laws and regulations, particularly as regards the creation or abolition of a stock exchange or of seats on the stock exchange.

(5) The Committee draws up proposals for changes in the laws or regulations concerning stock exchanges and stock exchange procedure.

(6) Finally, the Committee is responsible for keeping a register of brokers' intermediaries, or half-commission men as they are usually called.

[1] The issuing of foreign securities or their listing on the stock exchange is forbidden, unless special permission is granted by the Minister of Finance. The latter consults the Committee and, if it is in favour, special ministerial permission may be granted in certain cases.

ANNEX

BANQUE DE

WEEKLY

as at December 27,

Assets		In thousands of francs
1. Gold		4,322,226
2. Sight balances abroad		14,059,700
3. Advances to the Exchange Stabilization Fund.		
Contributions to the International Monetary Fund	2,204,033	
Other operations	342,000	
		2,546,033
4. Divisional coin		11,539
5. Postal cheque accounts		470,757
6. Loans to the government		5,450,000
7. Advances to the government		3,576,000
8. Discount portfolio:		
(*a*) Discounted French bills	6,033,786	
(*b*) Discounted foreign bills	554	
(*c*) Bills guaranteed by the National Cereals Office	1,122,575	
(*d*) Bills for the mobilization of medium-term credits	11,980,306	
		19,137,222
9. Negotiable bills purchased in France		2,266,491
10. Thirty-day advances against short-term government paper		140,844
11. Advances against securities		62,873
12. Advances against gold		—
13. Bills in course of collection		916,719
14. Miscellaneous		765,971
Total		53,726,374

FRANCE

RETURN

1962

Liabilities		In thousands of francs
Sight liabilities:		
15. Bank-notes in circulation		49,211,702
16. Creditor accounts:		
(*a*) The Treasury's current account . . .	60	
(*b*) Accounts of foreign banks, institutions and individuals . . .	194,589	
(*c*) Current accounts of French banks and financial institutions .	1,212,942	
(*d*) Other current and deposit accounts, provisions of funds and other sight liabilities . .	1,485,368	
		2,892,960
17. Capital of the Bank		150,000
18. Miscellaneous		1,471,712
Total . .		53,726,374

EXPLANATORY NOTE ON THE WEEKLY RETURN

ASSETS

1. GOLD

The Bank of France's gold holdings are valued on the basis of F 5,555·555 per kilogramme of fine gold.

2. SIGHT BALANCES ABROAD

These consist of sight deposits with banks and correspondents abroad, all the Bank's other currency holdings and any gold held which is not included in the 'gold' item proper.

3. ADVANCES TO THE EXCHANGE STABILIZATION FUND (Agreement of June 27, 1949, ratified by the law of July 22, 1949)

These are interest-free advances granted to the Exchange Stabilization Fund in application of the Agreement of June 27, 1949, to cover its franc requirements. The item is divided into two parts:

(*a*) the first, entitled '*Contributions to the International Monetary Fund*', shows the amounts France has subscribed to the Fund in various forms:

  (i) the part of its quota which has been paid in gold,
  (ii) the Fund's drawings on the part of its quota which has been paid in francs,
  (iii) the utilization of any supplementary resources made available by France within the framework of the Paris Agreements and the I.M.F. decision of January 5, 1962;

(*b*) the second, entitled '*Other operations*', shows the Bank's advances in francs to the Exchange Stabilization Fund for its current requirements.

4. DIVISIONAL COIN

This item comprises the coin of which the counterpart has been credited to the account of the Treasury and which, after being delivered to the Bank by the Mint, is held in the Bank's tills.

5. POSTAL CHEQUE ACCOUNTS

This item shows the total of the balances on the postal cheque accounts of the branches and main departments of the Bank with the Postal Administration.

6. LOANS TO THE GOVERNMENT (Agreement of October 29, 1959, ratified by the law of December 28, 1959; Agreement of May 3, 1962, ratified by the law of June 7, 1962)

This item has its origin in the amalgamation of various earlier loans into a single one. The ceiling for these loans, which was fixed at F 6,500 million by the Agreement concluded between the Bank and the government on October 29, 1959, was reduced to F 5,450 million by the Agreement of May 3, 1962.

On that date responsibility for contributions to the International Monetary Fund, which had previously lain with the Treasury, was transferred to the Exchange Stabilization Fund (see item 3(*a*) above). The funds which thus became reavailable to the Treasury were used—rounded off to a total of F 1,050 million—to repay part of the loans previously granted to it by the Bank.

The following funds are also earmarked for the redemption of loans to the government: the proceeds of the liquidation at any future date of the Exchange Stabilization Fund and the Fund for Supporting Long-Term Government Paper, together with any accounting profits accruing from a revaluation of the Bank's gold and foreign exchange holdings.

7. ADVANCES TO THE GOVERNMENT (Agreement of October 29, 1959, ratified by the law of December 28, 1959)

The total of these advances, for which the present ceiling is F 4,680 million, fluctuates continually as a result of the Bank's day-to-day transactions with the Treasury.

The profits made by the Exchange Stabilization Fund and the dividends payable by the Bank to the government are earmarked for the repayment of these advances, the ceiling for which is simultaneously lowered by a corresponding amount.

8. DISCOUNT PORTFOLIO

(*a*) *Discounted French bills*

This heading covers commercial bills (commercial paper and finance paper[1])—with the exception of those specified in paragraphs (*c*) and (*d*) below—payable in metropolitan France which have been presented to the Bank of France either by the banks or certain financial institutions for rediscounting or, to a very minor extent, by enterprises for direct discounting.

It also includes any tax-payment promissory notes presented by the Treasury for discounting. These are secured short-term bills made out to the order of the Treasury in settlement of taxes, duties and various other debts.

[1] Promissory notes, bankers' acceptances, bills accepted or guaranteed by the National Office for the Financing of Government Purchases, and commercial and agricultural warrants.

(*b*) *Discounted foreign bills*
This heading comprises discounted bills payable outside metropolitan France.

(*c*) *Bills guaranteed by the National Cereals Office* (Law of August 15, 1936, decree of July 29, 1939, and law of May 19, 1941)
This item consists of bills issued to finance cereal stocks.

These bills, which are drawn by the storage agencies and guaranteed by the National Cereals Office, are presented to the Bank of France for rediscounting by:

(i) the National Agricultural Credit Bank if the bills are drawn by the official storage co-operatives; or
(ii) the commercial banks if the bills are drawn by approved storage merchants or non-official storage co-operatives.

(*d*) *Bills for the mobilization of medium-term credits*
These are bills that are issued for the mobilization of:

(i) special loans to the building industry granted by the Building Contractors' Finance Institution, or in some cases by the Mortgage Loan Bank of France, which meet the conditions laid down in the laws of July 21, 1950, and April 15, 1953. These loans, which are guaranteed by the government, may be mobilized at the Bank of France during a certain period which varies according to the type of building involved ($2\frac{1}{2}$ years or $4\frac{1}{2}$ years) pending consolidation of the loans by the Mortgage Loan Bank; and
(ii) medium-term credits granted by banks, certain specialized financial institutions, regional agricultural credit institutions, the Mortgage Loan Bank of France or the Building Contractors' Finance Institution to help to finance purchases of equipment by industrial or commercial firms and agricultural enterprises, exports and the building of real property. These credits, which may, in certain cases, be endorsed by the National Office for the Financing of Government Purchases, can be mobilized at the Bank of France through the public or semi-public credit institutions,[1] either with the Bank's prior approval granted on the merits of the individual case or within the overall limits laid down for certain categories of operations.

9. NEGOTIABLE BILLS PURCHASED IN FRANCE (Decree of June 17, 1938)

This item, which consists of both short and medium-term government securities (Treasury bills) and private paper (bankers' acceptances, bills guaranteed unconditionally by the National Office

[1] The National Credit Bank, the Mortgage Loan Bank, the Deposit and Consignment Office and the National Agricultural Credit Bank.

for the Financing of Government Purchases, notes issued by the French Railways, mobilization paper guaranteed by a bank in respect of export sales, and paper bearing the signature of the Mortgage Loan Bank of France), shows the Bank's money-market transactions (purchases, sales and *pension* operations).

10. THIRTY-DAY ADVANCES AGAINST GOVERNMENT SECURITIES

These are short-term advances made to banks for periods of from five to thirty days against the collateral of government securities with a fixed maturity not exceeding two years. They are designed to facilitate the smooth functioning of the money market.

11. ADVANCES AGAINST SECURITIES

This heading shows the advances granted on current account to individuals, enterprises or banks against the collateral of either French Government paper or certain other securities listed by the General Council of the Bank (bonds of the French Railways, the City of Paris, the National Credit Bank, the Mortgage Loan Bank, the French Electricity Company, the French Gas Company, and the French Coal Mines, etc.).

12. ADVANCES AGAINST GOLD

Article 111 of the Codified Statutes (decree of December 31, 1936) empowers the Bank to grant advances against the deposit of gold bullion or coin.

No fresh advances were granted after June 1935 and all outstanding advances had been repaid by September 1937.

13. BILLS IN COURSE OF COLLECTION

This item comprises operations connected with the routine collection of cheques and matured bills, with the exception of disputed bills.

14. MISCELLANEOUS

The main items included under this heading are the expenditure accounts, miscellaneous debts in course of collection, various memorandum accounts, suspense items outstanding between the Bank's Head Office and its branches and, finally, the operating accounts of the reserve and contingency funds and of the staff funds.

LIABILITIES

SIGHT LIABILITIES

15. BANK-NOTES IN CIRCULATION

This item represents the total of notes in circulation, i.e. those held by the public, the public authorities and the banks.

16. CREDITOR ACCOUNTS

(a) The Treasury's current account

This account operates in the same way as an ordinary current account. To it are credited payments of all kinds made in favour of the Treasury, in particular payments from the Treasury's branch offices. It is debited with amounts paid out by order of authorized representatives of the Finance Administration (in cash or by transfer).

When necessary, this account also derives funds in round sums of one or more million francs from drawings on the 'Advances to the government' account within the limits of the ceiling placed on such advances. Conversely, any credit balance remaining at the end of the day is automatically reduced to less than F 1 million by the transfer of round sums of one or more million francs to the 'Advances to the government' account.

The Treasury holds no other bank account.

(b) Accounts of foreign banks, institutions and individuals

This item consists primarily of accounts of foreign central banks and international financial institutions (the International Monetary Fund, the Bank for International Settlements, etc.).

(c) Current accounts of French banks and financial institutions

These consist of accounts opened on behalf of:

(i) banks, credit co-operatives, agricultural credit institutions and other French financial institutions (the Deposit and Consignment Office, the National Credit Bank, etc.);
(ii) the Exchange Stabilization Fund.

(d) Other current and deposit accounts, provisions of funds and other sight liabilities

This item comprises current and deposit accounts opened in the name of individuals and private and nationalized enterprises (French Railways, French Electricity Company, French Coal Mines, etc.). It also covers promissory notes, cheques and letters of credit issued by the Bank in favour of its customers for the purpose of transferring funds from one place to another.

17. CAPITAL OF THE BANK

The Bank's capital, which is fixed at F 150 million, is held by the state.

18. MISCELLANEOUS

This heading covers various items, consisting mainly of profit accounts, suspense items outstanding between the Head Office and its branches, memorandum accounts, receipts awaiting appropriation and, finally, the various reserve and contingency funds of the Bank and the accounts in respect of the staff funds.

BANCA D'ITALIA

I

ORIGINS AND LEGAL FRAMEWORK

The Bank of Italy's Head Office and the offices of the central administration are in Rome.[1] At the end of 1962 the Bank had 108 branch offices, large and small, situated in all the main regional and provincial towns and in some smaller centres. It also maintains, for its banking operations, an extensive network of correspondents in Italy and abroad.

The Bank was created in 1893,[2] when the country's note-issuing institutions were reorganized, the Banca Nazionale nel Regno d'Italia (founded in 1849) and the two Tuscan banks of issue being merged into a single body. From 1893 onwards the new institution shared the note-issuing privilege with the two southern banks, the Banco di Napoli and the Banco di Sicilia. The issuing of currency was finally unified in 1926, at which date also the Bank first acquired the character of a central bank with special powers over the rest of the banking system.

As a result of the radical banking reform of 1936 the Bank was entrusted with new and much more important central-banking tasks. At the same time it underwent a formal change, ceasing to be a private joint-stock company of limited duration and acquiring its present legal status as an institution incorporated under public law[3] and of unlimited duration.

In connection with this change in the Bank's status it was laid down that, 'in order to safeguard the government's credit standing

[1] Article 2, paragraph 1, of the Bank's Statutes, approved by Decree No. 1067 of June 11, 1936, and amended by Decree No. 482 of April 19, 1948 (hereinafter referred to as 'the Statutes').

[2] Law No. 449 of August 10, 1893, and Agreement between the Bank and the Minister for the Treasury, dated October 30, 1894, and approved by Decree No. 533 of December 10, 1894. The provisions of the law and the agreement were amended several times between 1895 and 1898.

[3] Article 3 and Article 20, paragraph 1, of Decree-Law No. 375 of March 12, 1936, converted, with various amendments, into Law No. 141 of March 7, 1938, hereinafter referred to as the 'Banking Law' or the 'law of 1936', and also Article 1, paragraph 1, of the Statutes. The most important modifications arising out of the post-war changes in the country's political and administrative system are contained in Legislative Decree No. 691 of July 17, 1947, hereinafter referred to as the 'decree of 1947'.

and the continuity of direction of the issuing institution', the private shareholders should be repaid in full[1] and that the Bank's capital, amounting to 300 million lire, fully paid up, and subdivided into 300,000 registered shares of 1,000 lire each, could be owned only by bodies and institutions incorporated under public law.[2]

From this point of view, therefore, the Bank has continued to be a company, though of a somewhat anomalous nature. Its shareholders, though liable in the normal way to the extent of their participation in the capital, must have the prescribed legal status and may transfer shares only among themselves, with the prior consent of the Board of Directors.[3] The ownership of the Bank's capital is therefore strictly controlled and has, in fact, remained unchanged since the 1936 reform.

Derogations from common law were also introduced with regard to the powers and functions of the Bank's organs of management, and in the post-war period it was formally laid down in an appropriate legal provision that the Board of Directors, which is analogous to that of an ordinary company, should have no power to intervene in the performance of the central-banking tasks entrusted to the institution.[4] Further, members of the Board, who are elected independently by the shareholders' meeting, may not be members of parliament or engage in political activities; neither may they belong to credit institutions subject to bank supervision, and thus not to any bodies participating in the Bank's capital which fall within this category.[5]

At the end of 1962 the distribution of the Bank's shares among the five categories of institutions specified by the Banking Law was as follows:

	Number	Shares	Percentage	Votes
1. Savings banks . . .	77	178,000	59·3	468
2. Credit institutions incorporated under public law. .	8	54,500	18·2	141
3. Banks of national importance	3	21,000	7·0	54
4. Social security institutions .	1	15,000	5·0	34
5. Insurance institutions. .	9	31,500	10·5	99
Total. .	98	300,000	100·0	796

[1] Articles 20 and 21 of the Banking Law.
[2] Article 20, paragraph 3, of the Banking Law and Article 3 of the Statutes.
[3] Article 3, paragraph 3, and Article 4 of the Statutes.
[4] Article 5, paragraph 1, of the decree of 1947.
[5] Article 62 of the Statutes.

Out of the net profits after depreciation shown in the approved balance sheet, up to 20 per cent is appropriated to the ordinary reserve fund and a dividend not exceeding 6 per cent of the nominal capital is paid to the shareholders. The remainder may be used, on the proposal of the Board of Directors and with the approval of the Minister for the Treasury, to constitute special funds and extraordinary reserves up to a further 20 per cent of the net profits, and to distribute to the shareholders, as a supplement to the dividend, a further amount not exceeding 4 per cent of the capital. The residue goes to the state.[1]

The provisions governing the Bank's legal status and activities are contained in Section III of the Banking Law of 1936 and in the Statutes approved the same year in implementation of Article 24 of that law. Apart from the Banking Law, there are a number of other legal provisions and regulations which define the relations between the Bank and the government and which are not contained in any consolidation act; the most important of these are referred to at the appropriate points in the following sections. Special mention should be made of the Consolidation Act concerning issuing institutions and the circulation of bank-notes,[2] which was published in 1910, when there were still several issuing bodies.

In view of the fact that the state does not participate in any way in the Bank's capital and thus has no say through the organs of management in its ordinary administration, the government has been given by law certain powers of control and supervision over the Bank's activities, to which further reference will be made later.

In general it can be said that, while regulative power over all the fields of activity entrusted to the Bank lies with the government alone, the Bank enjoys wide discretionary powers in applying and interpreting the government's directives and in issuing instructions and executive regulations within the fields for which it is responsible. It is entitled to obtain from public bodies all the information, co-operation and assistance which it may require in order to carry out its duties.[3]

The action taken by the Bank must, however, remain within the framework of the government's general directives, and especially of those issued by the Interministerial Committee for Credit and Savings, which is ultimately responsible to Parliament for monetary and credit policy; therefore its whole conduct must be at one with

[1] Article 54, paragraphs 6, 7 and 8, of the Statutes and Article 3 of the ministerial decree of December 31, 1936, issued in implementation of Decree-Law No. 1647 of September 5, 1935.

[2] Approved by Decree No. 204 of April 28, 1910, and hereinafter referred to as the 'Consolidation Act of 1910'.

[3] Articles 16 and 17 of the Banking Law and Article 3 of the decree of 1947.

that of the government, and it is not conceivable that it should follow a line contrary to the directives just referred to; on the other hand, the government has never sought to impose its will in matters which lie within the Bank's sphere of action.

II

FUNCTIONS AND OBJECTIVES

Article 1 of the Statutes lays down that the Bank shall have two objectives in its ordinary activity, specifying that it

(1) 'shall carry out banking functions' and
(2) 'may issue bearer instruments and shall, as the sole issuing institution, issue bank-notes within the limits and according to the rules laid down by law'.

As the Bank has been prohibited since 1936 from doing discount business with private firms or individuals and has, moreover, since the last war of its own accord gradually ceased to grant advances to non-bank customers, the first of these objectives now means merely that the Bank must act as lender of last resort for the banks.

As regards the second objective, by virtue of its note-issuing monopoly the Bank has become responsible not only for ensuring that cash payments function smoothly but also for regulating the volume of money according to the needs of the market.

Besides these two objectives, which could be called 'constitutional', the Bank performs other functions not mentioned in the Statutes but more or less explicitly defined either in legislation or in agreements concluded with the government. These functions may be summarized as follows:

(3) to ensure, by means of ordinary advances up to a fixed limit, that the Treasury's cash position is sufficiently flexible;
(4) to guarantee the rapid and reliable functioning of the state's collection and payments system;
(5) to promote and facilitate cashless payments, and cashless exchanges and sales of credit instruments, etc.;
(6) to facilitate and reduce the cost of movements of funds from one centre to another;
(7) to implement legislation concerning the protection of savings and the control of credit-granting and the government's general directives regarding monetary and banking matters;
(8) to see that savings deposits are administered and credits granted in accordance with the law and the rules of good banking; and

(9) to arrange for the compilation and publication of full statistics concerning the currency, credit and savings, and for the uniform presentation of the balance sheets and returns of credit institutions.

Lastly, the Bank has certain other functions of a more general nature which are not contained either explicitly or implicitly in any legal provisions but which, with the moral responsibilities they entail, have been vested in it by practice and tradition.

These functions cannot, however, be summarized in any hard-and-fast list. This is partly because they tend to alter over time, in accordance with changes in economic and social conditions and in needs and trends of thought. In addition, they are mostly objectives of a general nature to the attainment of which the Bank contributes in greater or lesser degree within the broader framework of government policy. By way of example, the Bank may be said to be pursuing at present the following 'political' aims:

(1) to safeguard the stability of the internal and external value of the currency;
(2) to help to maintain internal monetary equilibrium;
(3) to safeguard the government's credit standing and the good name of institutions active in the credit and savings sector;
(4) to encourage specialization and technical progress in the field of banking and finance;
(5) to promote the formation of savings[1] and the availability of credit on a sufficient scale to meet the requirements of the country's economic development;
(6) to endeavour to ensure the orderly functioning of the foreign exchange market by assisting the Italian Exchange Office in the performance of its duties;
(7) to help the government and financial and credit institutions with advice and expert opinion; and
(8) to establish a basis for co-operation with kindred foreign institutions and with international institutions by encouraging the development of international relations in the field of money and credit.

III

STRUCTURE AND ADMINISTRATION

Under Article 5 of the Statutes, the powers of the Bank are vested in

(*a*) the General Meeting of shareholders,
(*b*) the Board of Directors and the Committee of the Board of Directors, and

[1] Article 47 of the Constitution.

(*c*) the Governor, the General Manager and the Deputy General Manager.

The Bank's administration is supervised by the Board of Auditors and the censors. The regional executive organs are the Boards and the managers of the branches.

ADMINISTRATIVE ORGANS

THE GENERAL MEETING OF SHAREHOLDERS

The supreme governing body of the Bank is the General Meeting of shareholders, which in character is much the same as the general meeting of shareholders of any ordinary company. Shareholders who have owned one hundred or more shares in the Bank's capital for at least three months are entitled to attend, and they have this right irrespective of any limitations to which their shares may be subject.[1]

As a result of the transformation of the Bank into a public body in 1936, and of the laying-down of precise rules regarding what bodies may hold shares in its capital, changes of ownership have become rare and the composition of the meeting is thus almost always the same. The meeting is presided over, *ex officio*, by the Governor, and it must be attended by a Treasury Inspector duly appointed by the Minister for the Treasury.[2]

The Ordinary General Meeting is convened by the Board of Directors not less than fifteen days before the date fixed for the meeting and is held in Rome not later than May 31st of each year.[3] The agenda is drawn up by the Board of Directors and must include the approving of the balance sheet, nominations of auditors and all proposals which have been submitted to the Board of Directors by the end of March at the signed request of one or more shareholders who between them hold 5,000 or more shares and have done so for at least three months.[4]

Extraordinary meetings can be convened by the same procedure by a decision of the Board of Directors, at the request either of the auditors or of shareholders who between them hold 20,000 or more shares and have done so for at least three months; within thirty days of the request the Board draws up the agenda for the meeting, which

[1] Article 6, paragraphs 2 and 3, of the Statutes.

[2] Article 5, paragraph 2, of the decree of 1947, and Article 114, paragraph 3, of the Consolidation Act of 1910.

[3] Article 6, paragraph 1, of the Statutes. In practice it has now for a number of years been the custom for the Ordinary General Meeting to be held on the last working day in May.

[4] Article 7, paragraphs 1 and 2, and Article 11 of the Statutes.

must take place within two months of the date when the request was made.[1]

The shareholders entitled to attend the General Meeting have one vote for every 100 shares up to 500, and one vote for every 500 shares above 500, provided that they have held them for not less than three months. The representative or proxy of each shareholding institution, who must not be a member of the Board of Directors or the Board of Auditors, may in no case cast more than fifty votes.[2]

Lastly, provision is made for a third kind of shareholders' meeting to be held at the Bank's regional main offices. The sole function of this type of meeting is to elect, by secret ballot, the members of the Board of Directors. These meetings were provided for because the ownership of the Bank's capital is, owing to the regional origin of the Bank, spread over a wide geographical area. About three-fifths of the shares belong to savings banks, which are in general typically local institutions.

THE BOARD OF DIRECTORS

The Board of Directors is the Bank's elected administrative body; in the Bank's current business it represents the interests of its shareholders and also, indirectly, because of the system by which its members are elected, regional economic interests. In its own particular field, which is the administration of banking business, it contributes a fund of local knowledge and personal experience which greatly assists in the efficient conduct of the Bank's operations and of its dealings with outside parties.

The Board consists of the Governor and the twelve directors who are elected at the General Meetings convened at the Bank's regional main offices, one being appointed for each; the meetings for the Florence and Leghorn offices are held, for historical reasons, jointly at the Florence office, for the purpose of appointing a single representative.[3]

The members of the Board hold office for three years. Each year four of them retire. Those retiring are immediately eligible for re-election. In order to safeguard the independence of the Board, it is laid down that its members may not include senators or members of parliament or other persons primarily engaged in political work; lastly (and this is a principle which applies to all the Bank's officials

[1] Article 12 of the Statutes. [2] Article 8 of the Statutes.

[3] Combined provisions of Article 22, paragraph 1, of the Banking Law and Article 5, paragraph 2, of the decree of 1947; also Article 17, paragraph 1, of the Statutes.

and to other members of the staff), they must not belong to any credit institution in any capacity whatsoever.[1]

The Board of Directors meets in Rome under the chairmanship of the Governor; its meetings are also attended by the General Manager, who, except when he is replacing the Governor, is present only in an advisory capacity. The Deputy General Manager acts as secretary, and the auditors currently in office may attend the meetings.[2] The representative of the Minister for the Treasury is entitled to attend as an observer.

The Board meetings are of two kinds, ordinary and extraordinary. The former are as a rule held once every three months at the proposal of the Governor, and the latter at the Governor's discretion, or at the request, supported by appropriate reasons, of at least three directors.

The Board of Directors appoints and dismisses the Governor, the General Manager and the Deputy General Manager and fixes their emoluments and the other terms of their service. For the purpose of taking such decisions, which are subject to final approval by Presidential Decree on the recommendation of the Prime Minister, in agreement with the Minister for the Treasury and after consultation with the Cabinet, the Board of Directors is summoned to an extraordinary meeting at the proposal of the Governor or, if the matter in question is the appointment of the Governor himself, at the proposal of the director who is senior in tenure of office and in age.

Under Article 20 of the Statutes, the Board of Directors is responsible for the general administration of the Bank.

Finally, the Board of Directors expresses its opinion and decides on all other matters which are not explicitly reserved for decision by the General Meeting and which the Governor deems fit to submit to it. It is, however, forbidden by law to intervene in any way in matters within the sphere of responsibility of the Interministerial Committee for Credit and Savings, whose decisions and directives are executed (as is also prescribed by law) by the Bank, using its own staff or that of other official bodies.[3]

THE COMMITTEE OF THE BOARD OF DIRECTORS

To accelerate and facilitate the conduct of the Bank's current business there is a second, similar but smaller, administrative body, consisting of members of the Board of Directors, to assist the

[1] Article 132 of the Consolidation Act of 1910, Article 22 of the Banking Law and Articles 17 and 62 of the Statutes.

[2] Article 17, paragraphs 5 and 6, Article 18, paragraph 1, and Articles 21 and 23, paragraph 6, of the Statutes.

[3] Article 20, section 19, and Article 5, paragraph 1, of the Statutes, and Articles 1, 2, 3 and 5 of the decree of 1947.

Governor. It is a standing committee with consultative functions though it is occasionally also called upon to take decisions.

At its first meeting of the year the Board of Directors selects four of its members, who are eligible for reappointment, to form the Committee, the chairman of which is the Governor. The meetings are attended by the General Manager, in a consultative capacity, and the Deputy General Manager, who acts as secretary. The Treasury representative is present as an observer. The Committee meets as a rule once a month, on the proposal of the Governor, and adopts resolutions according to the same rules as the Board.

EXECUTIVE ORGANS

THE GOVERNOR

The Governor is the Bank's highest executive. The duties attached to his office are more clearly defined and, in some ways, more important than those of any of its other organs. His appointment or dismissal, like that of the General Manager and Deputy General Manager, is decided by the Board of Directors, the resolution in question being taken, as already mentioned, at a special meeting subject to specific formal safeguards; it has to be approved by the Cabinet and confirmed by a decree of the President of the Republic on the recommendation of the Prime Minister.[1]

The Governor may not be a member of parliament or hold any other political office;[2] he must be an Italian citizen and, like other members of the Bank's staff, may not belong to any other credit institution, engage in trade, carry out stock exchange transactions, or act as a director of, possess any interest in or assume any kind of responsibility for companies, save, in the latter case only, when an exception is expressly authorized by the Board of Directors on the grounds that it is in the Bank's interest.[3]

The Governor is the head of the central bank, and is often described as such in the laws and regulations. He must observe the laws, regulations and Statutes and see that they are observed and direct and supervise all the Bank's activities. He superintends the Head Office and the regional establishments—assisted by the General Manager and the Deputy General Manager—and any other bodies in any way subordinate to the Bank.

Apart, however, from the prominent position which he holds in the administration by virtue of the Statutes, more generally his

[1] Article 133 of the Consolidation Act of 1910, Article 24 of the Banking Law and Article 19 of the Statutes.

[2] Article 132 of the Consolidation Act of 1910 and Article 62, paragraph 1, of the Statutes.

[3] Article 17, paragraph 7, and Article 61, paragraph 1, of the Statutes.

pre-eminent status is due mainly to the special functions directly entrusted to him by law in his capacity as head of the Bank, completely independently of the organs of management. The Governor is generally recognized as bearing the ultimate technical responsibility for all monetary and credit matters, and, as head of the bank supervisory system, he is also regarded as the country's supreme banking authority.

Under Article 25 of the Statutes the Governor has virtually full freedom to decide all questions concerning operations whereby the Bank can affect the volume of the money circulation and of bank liquidity. Lastly, he has the sole right to make to the Minister for the Treasury, when he deems it advisable, proposals regarding changes in the official discount rate and the interest rate on advances.[1]

The Governor presides over the General Meeting of shareholders and presents to it, at the Ordinary Meeting held at the end of May, the Annual Report on the Bank's activities.[2] He proposes to the Board of Directors the appointment and dismissal of the 'external officials' of the branches. He also proposes the appointment and dismissal of the Bank's officers, in which connection he has the special task of deciding on promotions of senior staff and the appointment, assignment and transfer of branch managers.[3]

Over and above the administrative duties assigned to him by the Statutes as head of the central bank, the Governor has, as already mentioned, other official tasks which are allotted to him by law and by various regulations. By far the most important of these are his functions and powers as head of the bank supervisory system, as the agent responsible for carrying out the decisions of the Interministerial Committee for Credit and Savings and as the government's adviser on monetary and credit matters.

Among his other official functions, a very important one is that of head and Chairman of the Board of Directors of the Italian Exchange Office, a public body which has the monopoly of gold transactions with foreign countries and of dealings in foreign exchange, under the supervision of the Ministry of the Treasury. Lastly, the present Governor is a member of the Board of Directors of the Bank for International Settlements in Basle.

GENERAL MANAGER AND DEPUTY GENERAL MANAGER

The General Manager and the Deputy General Manager are the Bank's two other central executive authorities. In view of the extent and importance of the Governor's functions, he needs to be assisted

[1] The Minister for the Treasury also has the right to order changes in the Bank's deposit rate (see page 206). [2] Article 6 of the Statutes.

[3] Article 25, paragraphs 6 and 7, Article 30, paragraph 4, and Article 34, paragraph 2, of the Statutes.

in his administrative and directing capacity by colleagues who, though formally in a subordinate position, have sufficiently wide statutory powers firstly for the continuity of the Bank's management to be ensured in all circumstances and secondly to permit an efficient division of labour—subject always to the allocation of responsibilities laid down by the Statutes and laws.

With regard to the former of these two requirements the Statutes are explicit: the General Manager represents the Governor in the latter's absence in all his official functions; *vis-à-vis* outside parties and public bodies the General Manager's signature constitutes full proof of the absence of the Governor, who is not entitled to delegate his right to sign for the Bank.[1] The Deputy General Manager replaces the General Manager in his absence; if both the Governor and the General Manager are absent at the same time, he also replaces the Governor. *Vis-à-vis* outside parties and public bodies the signature of the Deputy General Manager constitutes full proof of the absence of the General Manager, who, however, is entitled, with the prior consent of the Governor, to delegate his right to sign for the Bank.[2]

In regard to the division of functions between the Governor, the General Manager and the Deputy General Manager, the Statutes contain only broad general rules, the intention having been to leave it to the individuals concerned to decide *pro tempore* how to divide out the various responsibilities. According to the Statutes, the Governor is responsible for all acts, contracts or decisions not expressly reserved to another of the Bank's organs; the General Manager's competence covers 'acts of ordinary administration' and may be delegated, while the Deputy General Manager has to 'assist the General Manager in carrying out his functions'.[3]

BRANCH MANAGERS AND EXTERNAL OFFICIALS

The historical process by which the Bank has become what it now is and the functions which it performs have led to the development of a large regional organization. The main local executive officers provided for by the Statutes are the branch managers and the external officials. The managers are, properly speaking, an offshoot of the central executive authorities, to whom they are directly subordinate; the external officials, like the members of the Board of Directors, are to be regarded as representing local economic interests on the Bank's management and—though not, like the members of the Board,

[1] Article 28 of the Statutes.

[2] Article 27, paragraph 1, and Article 29 of the Statutes.

[3] Article 25, penultimate paragraph, Article 27, paragraph 1, and Article 29, paragraph 1, of the Statutes.

reflecting the distribution of the Bank's capital—constitute in various ways a ramification of the central organs of management.

The managers are the heads of the branches. In the towns in which the Treasury has provincial offices which are run by the Bank, the managers are also the heads of these offices, with all the rights and duties attaching to that position. They take part *ex officio*, with the right to speak and vote, in the meetings of the governing boards of the regional main offices and of the branches, and also in the meetings of the discount committees formed by the members of these boards to examine the soundness of the branches' operations.[1]

From time to time the Bank of Italy manager calls a meeting of the managers of the various credit institutions operating in his area; at these meetings local banking problems are discussed and the manager has the opportunity of explaining the aims of the Bank's policy and obtaining first-hand information on economic trends in the regions for which he is responsible.

STATUTORY SUPERVISORY BODIES

BOARD OF AUDITORS

The auditors are five in number, plus two alternates; they are appointed annually by the General Meeting of shareholders, work as a body and supervise the whole of the Bank's administration from the point of view of the observance of the law, the Statutes and the General Regulations.

They examine the returns, the balance sheets and the profit and loss accounts and give their views on the distribution of the annual dividend. They may attend the meetings of the Board of Directors, to which they submit a report on the balance sheet and the allocation of the profits, and, when necessary, they submit to the Governor their own observations and any they may have received from the censors.[2]

CENSORS

The censors are the auditors' agents in the Bank's regional organization and are selected by the Board of Directors from among the Bank's external officials, not more than four being attached to each regional main office or branch. They keep themselves informed of how business is going in the office or branch to which they are

[1] Article 30, paragraph 3, and Articles 33–36 of the Statutes.

[2] Article 7, paragraph 1, Article 20, section 15, Article 23 and Articles 57–58 of the Statutes.

attached and check its balance sheet twice a year; they are entitled to obtain from the managers any information they consider necessary in order to carry out their allotted task.

ORGANIZATION OF THE CENTRAL OFFICES

The central organization, unlike the regional organization, is not specifically defined in the Statutes; these only state that 'the seat of the Bank's Head Office shall be in Rome' (Article 2, paragraph 1) and mention the Head Office several times as the point at which all the Bank's activities converge. It consists at present of fifteen departments, each of which comprises a varying number of offices performing related functions. They are as follows:

(1) General Secretariat
(2) Internal Economic and Money-Market Research Department
(3) Foreign Economic and Balance-of-Payments Research Department
(4) General Inspectorate
(5) Organization Department
(6) Personnel Department
(7) Discounts, Advances and Correspondents
(8) Relations with the Treasury and Treasury Offices
(9) Domestic Relations
(10) Foreign Relations
(11) Legal Adviser's Department
(12) General Accountancy Department
(13) Administration of Premises and Properties
(14) Bank Supervisory Department[1]
(15) Central Cash Department

The officials in charge of the Head Office departments, though enjoying freedom of action in running the offices under their control, are not entitled to sign for the Bank except, within set limits and then usually with a joint signature, with regard to matters expressly delegated to them by the General Manager. They are in all cases obliged to report to and consult the management concerning everything connected with the services of which they are in charge, since, under the Statutes, only the management has the power to make decisions. Following a recent reform, the 'general officers' (*impiegati generali*), whose number has been increased to six, are responsible for superintending the work of one or more departments and for co-ordination between the central and regional organizations.

[1] The Bank Supervisory Department is divided into three sections, viz.: General Business, Banks and Special Credit Institutions, and Inspectorate.

The General Secretariat is in charge, in particular, of the Bank's general business and the note circulation. The Economic Research Departments study economic trends at home and abroad, see to the publication of the bi-monthly statistical bulletin and collect information and other material for the Bank's Annual Report to the General Meeting.

The General Inspectorate carries out internal inspections at the regional establishments and the Head Office, independently of those carried out by the special and governmental supervisory bodies. Separate from this is the Bank Supervisory Department, which is solely responsible for the supervision of the banking system in accordance with the Banking Law. Inspection in the field of foreign exchange control is carried out by the Foreign Relations Department, in collaboration with the General Inspectorate and the Italian Exchange Office. The Organization and Personnel Departments and the Department for the Administration of Premises and Properties are technical departments.

The remaining central departments are concerned with the Bank's operations. Their fields of activity can be subdivided into four groups:

(*a*) lending operations (discounts and advances, including relations with correspondents in Italy);
(*b*) acceptance of deposits, etc., and financial operations (domestic relations, including the clearing-house system);
(*c*) relations with the Treasury and the Treasury offices;
(*d*) foreign relations, extended to include the Bank's foreign exchange control functions, its relations with the Italian Exchange Office and its dealings with foreign correspondents.

Lastly, the General Accountancy Department centralizes all entries in the Bank's books, which are now largely mechanized.[1]

ORGANIZATION OF THE REGIONAL OFFICES

The regional organization consists at present of 108 branches—comprising thirteen regional main offices, eighty branch offices and fifteen agencies or the equivalent—plus seven representative offices abroad. Under the agreements concluded with the state for the running of the Treasury offices, the Bank must have a branch in each of the ninety-one provinces of the Republic;[2] the remaining

[1] In mid-1961 the Bank's staff numbered 7,200, of whom about 10 per cent were women and another 10 per cent skilled or unskilled workers (in the note-printing works); officials in the higher categories represented 11 per cent and staff attached to the branches 72 per cent of the total; 29 per cent of those employed worked in Treasury offices; the ratio between the Bank's pensioners and its actively employed staff is 1 : 2.1.

[2] Article 1 of Decree No. 16 of January 15, 1895 (Regulations concerning the Treasury offices), and Article 2, paragraph 4, of the Statutes.

seventeen branches are either subsidiary establishments situated in the capital and the major centres or more or less independent establishments operating in economically important centres. Altogether, there are fifty branches, large and small, operating in northern Italy, twenty-three in central Italy and thirty-five in southern Italy, including the islands. All changes in the position as regards the Bank's regional main offices and other branches require the approval of the Board of Directors and the Minister for the Treasury.[1]

EXTERNAL SUPERVISION

As already mentioned, the state does not participate in the Bank's capital and thus is not represented on the Bank's organs of management. Further, under the Statutes, representatives of the state may not hold any office in the Bank's administration or belong to its supervisory bodies. In view, however, of the public importance of some of the powers and functions conferred on the Bank by law, and of the general services which it has to perform on behalf of the state, for which purposes the Bank has been legally exempted from the rules of common law and declared to be a public body, the legislature has reserved to the government various powers of regulating, supervising and inspecting its activities. These may be grouped, according to their main aims, in five categories.

CONSTITUTIONAL POWERS

Under the Banking Law the Statutes and any amendments thereto must be approved by a decree of the Head of the State, on a recommendation submitted by the Prime Minister and formulated in agreement with the Minister for the Treasury.[2] The same procedure—with the addition that the Cabinet must also be consulted—is prescribed for the appointment and dismissal of the Governor, the General Manager and the Deputy General Manager. Actually all the appointments decided upon by the Board of Directors have up to now invariably been sanctioned by the government without any change or recommendation.

With regard to the Bank's administration, the Minister for the Treasury is responsible for authorizing any change regarding the Bank's regional main offices and other branches which has been agreed to by the Board of Directors[3] and for approving proposals

[1] Article 2, last paragraph, of the Statutes and Article 2 of the Consolidation Act of 1910.

[2] Article 133 of the Consolidation Act of 1910 and Article 24 of the Banking Law.

[3] Article 2 of the Consolidation Act of 1910 and Article 2, last paragraph, of the Statutes.

for the utilization of the Bank's own reserves, the creation of special funds out of unallocated profits and the distribution of supplementary dividends out of the remaining profits.[1]

In addition to these powers of control, there are a number of very important supervisory powers relating to the activities of the Bank's organs of management. The Minister for the Treasury must be duly informed in advance of the convening of General Meetings of shareholders and Board meetings, and of the matters which are on the agenda.[2] It is laid down that the General Meeting and meetings of the Board of Directors and of the Committee of the Board of Directors must be duly attended by a Treasury Inspector or a government official expressly appointed by the Minister for the Treasury (the so-called 'Treasury representative'); the latter is entitled to suspend the execution of any resolutions which he considers contrary to the law, the regulations or the Statutes.[3]

POWERS RELATING TO THE BANK'S FUNCTION AS THE SOLE NOTE-ISSUING INSTITUTION

These supervisory powers were introduced by the Consolidation Act of 1910 in connection with the privilege conferred on the Bank in its capacity as a body incorporated under private law, at a time when there was more than one issuing institution. Nevertheless, they must be regarded as having been confirmed also in respect of the Bank's functions as the sole public body possessing the right of issue in accordance with the principles laid down in 1936, these powers having been expressly referred to once more both in that law and in the decree of 1947, which adapted their application to the changed political system of the post-war period.[4]

The Minister for the Treasury is given regulative powers in respect of everything connected with the production and use of stocks of new notes and the replacement and cancellation of notes which are worn or damaged, together with authority to issue decrees approving the form, characteristics and quantity of notes which the Bank proposes to print.

Apart from applying to technical and administrative matters relating to the note issue, the powers conferred on the Minister for the Treasury also include that of keeping a check on the legality of the Bank's operations, in the form of specific and general super-

[1] Article 54, paragraph 7, and Articles 55 and 56 of the Statutes; see page 185.

[2] Article 114, paragraph 1, of the Consolidation Act of 1910.

[3] Article 114, paragraph 3, of the Consolidation Act of 1910 and Article 5, paragraph 2, of the decree of 1947.

[4] Article 14, paragraph 1, of the law of 1936 and Article 4 of the decree of 1947.

visory and inspecting functions.[1] This 'government supervision' is carried out through:

(*a*) a Permanent Commission for the Supervision of the Note Circulation and the Central Bank—composed of eight members of parliament elected by the two Chambers and of five members appointed by the government;
(*b*) a General Inspectorate at the Ministry for monetary supervision and control, which is responsible for permanent direct supervision and for periodical general inspections;
(*c*) extraordinary inspections, general and special, which can be carried out at any time.

POWERS RELATING TO THE BANK'S FUNCTION AS THE BODY RESPONSIBLE FOR SUPERVISING THE BANKING SYSTEM

Under the terms of the law of 1936 and subsequent amendments thereto the Bank performs supervisory functions relating to the safeguarding of savings and to credit-granting and foreign exchange matters. In this connection the Bank carries out the resolutions of the Interministerial Committee for Credit and Savings. All regulations applying to savings and credit and those concerning the supervision of banks under the law of 1936 are issued, in so far as responsibility for them is not expressly entrusted to the Governor or the other organs of the Bank, by decrees of the Minister for the Treasury, after consultation, except in cases of special urgency, with the Interministerial Committee.[2]

POWERS RELATING TO THE BANK'S FUNCTION IN RUNNING THE TREASURY OFFICES AND OTHER SERVICES ON BEHALF OF THE STATE

The running of the Treasury offices was entrusted to the Bank in 1894 and since then it may be said to have become one of the functions of the central bank. Apart from its duty to submit reports and to observe the rules regarding the administration of the state's assets and its general accounting procedures, as well as numerous other regulations, the Bank has to act, in performing this function, on directions from the Directorate General of the Treasury and the central state administrative departments concerned.[3]

[1] Article 108 and Chapter VIII of the Consolidation Act of 1910.
[2] Article 6 of the decree of 1947.
[3] Article 118 of the instructions approved by the ministerial decree of June 30, 1939.

POWERS RELATING TO THE BANK'S FUNCTIONS AS ADMINISTRATOR AND CUSTODIAN OF THE OFFICIAL FOREIGN EXCHANGE RESERVES ENTRUSTED TO THE ITALIAN EXCHANGE OFFICE

The Italian Exchange Office was created in 1945 with a view to concentrating in the hands of one institution the country's entire stock of international reserves. Although this Office is formally an institution incorporated under public law, independently run and possessing a separate legal personality, it may, owing to its particularly close links with the Bank, be regarded, for the purpose of monetary policy, as an institution affiliated to the Bank.

In view of this and of the public importance of its functions, it is laid down by law that the Office is subject to the direct supervision of the Ministry of the Treasury and that some of the members of its Board of Directors are to be appointed by the government;[1] moreover, any increase in its capital must be approved by a ministerial decree, as must also the appointment of the auditors, who submit the balance sheet, together with their own report, direct to the Minister.

RETURN AND BALANCE SHEET

The central bank is required to draw up a statement of its accounts and operations as at the close of business on the tenth, twentieth and last days of each month; the form in which these returns are presented is approved by ministerial decree. They must show separately the various categories of assets and liabilities comprising the balance-sheet total (see annex). Any change in the form of the return is to be sanctioned by the Minister for the Treasury after consultation with the Permanent Commission for the Supervision of the Central Bank.[2]

The returns must be sent to the Ministry of the Treasury within eight days of the date to which they refer. The Inspectorate General of the Ministry is responsible for arranging for publication of the end-of-month return in the monthly supplement to the Official Gazette containing the summary of the Treasury accounts, which appears about four or five weeks after the date of the closing of accounts;[3] in the meantime the Bank publishes the end-of-month return in the fortnightly supplement to its own bi-monthly Bulletin.

[1] Articles 1 and 4 of Legislative Decree No. 331 of May 17, 1945.

[2] Article 118, paragraph 1, and Article 111, section (*c*), paragraph 3, of the Consolidation Act of 1910.

[3] Article 118, last paragraph, of the Consolidation Act of 1910.

IV

POWERS AND ACTIVITIES

NOTE ISSUE

The Bank has been the only note-issuing institution since June 30, 1926.[1] It was, however, at the time of the banking reform of 1936 that the present legal basis of the note-issuing function was established.

Until 1936 the right of issue had always taken the traditional form of a privilege granted by the state to a private company for a fixed period (generally coterminous with the existence of the company) to which were attached certain obligations connected with the actual granting of the privilege and the legal-tender character of the notes. After the coming into force of the Banking Law, whereby the Bank was made into a 'bank of issue incorporated under public law', the issuing function acquired its present character as a prerogative conferred for an indefinite period on the institution constitutionally entrusted with it.

Although the law of 1936 is particularly explicit in assigning to the Bank the function of 'bank of issue', it does not anywhere specify exactly what powers attach to this function. This has been interpreted to mean that the legislature wished to leave the existing system unchanged both as regards the administrative regulations and the government's supervisory powers and as regards the legal-tender character and inconvertibility of the notes as established in 1935.

Apart from the notes issued by the Bank, there is now no other kind of legal-tender paper money in circulation in Italy.

At present the Bank is authorized to issue notes in the denominations of 1,000, 5,000 and 10,000 lire. The 500-lire note now in circulation is to be withdrawn soon and replaced by a silver coin of the same value.[2] The 1,000-lire note is the only one remaining of those introduced by the Consolidation Act of 1910. The 5,000 and 10,000-lire denominations were created after the war in view of the changed value of the currency;[3] these two denominations now account for by far the largest proportion of the circulation (8 and 82 per cent respectively).

At the same time the Mint is authorized to manufacture and the Treasury to put into circulation metal coins of the face value of 1, 2, 5, 10, 20, 50, 100 and 500 lire. The laws providing for the

[1] Article 1 of Decree-Law No. 812 of May 6, 1926, converted into Law No. 1362 of May 25, 1926.

[2] Article 2 of Law No. 1141 of November 21, 1957.

[3] Law No. 1273 of October 7, 1948.

creation of these money-tokens, which are limited legal tender, entrust to the Minister for the Treasury the task of fixing by decree the amounts to be coined, the external characteristics of the coins and the date of their being put into circulation.

By virtue of a decree issued at the end of 1927 the Bank had been obliged to convert its notes into gold or into foreign exchange equivalent thereto, and to hold available for that purpose a reserve of gold or foreign exchange representing not less than 40 per cent of the amount of the note circulation and of its other sight liabilities.[1] Moreover, the Bank had been required by another decree to intervene on the foreign exchange market in order to keep the exchange rates between the limits of the gold points.[2]

Both the convertibility and the reserve obligation were 'temporarily' suspended in 1935,[3] but they have never been reintroduced. In December 1958 an administrative order was issued stating that Italian lire obtained by non-residents as a result of transactions permitted by the foreign exchange regulations were convertible into any foreign currency. Under these regulations Italian bank-notes may be imported and re-exported by non-residents without limitation as to amount; residents, on the other hand, may export freely up to 50,000 lire's worth, which amount does not include any other transfers of payment media, in lire or foreign exchange, provided for by law.

The Bank is thus not legally obliged nowadays to maintain a fixed reserve of gold or foreign exchange as cover for its notes and other sight liabilities. In January 1960 the Bank's gold holdings were revalued, in relation to the old (1936) gold parity of the lira, on the basis of the price of 703·297 396 lire per fine gramme, corresponding to the price applied by the U.S. Treasury converted at the middle exchange rate of 625 lire to the dollar.[4] Following an agreement with the Italian Exchange Office, the amount of the Bank's gold holdings was brought up to 1,000 milliard lire in December 1960.[5]

[1] Article 1 of Decree No. 1377 of June 17, 1928, concerning the implementation of the agreements concluded between the Treasury and the Bank under Decree-Law No. 2325 of December 21, 1927, converted into Law No. 1453 of June 7, 1928.

[2] Decree No. 242 of February 26, 1928.

[3] Decree-Law No. 1293 of July 21, 1935.

[4] The price fixed for the revaluation of the Bank's gold holdings was used in declaring the official parity of the Italian lira to the International Monetary Fund (Article 1 of Decree-Law No. 14 of January 28, 1960, converted into Law No. 184 of March 3, 1960).

[5] In conformity with the Statutes (Article 41, section 6), the Bank buys gold without limitation as to amount at its own offices at a price fixed weekly on the basis of the official exchange rate for the dollar.

Since 1936 the Bank has paid the state a global stamp duty at an annual rate equivalent to one-tenth of the discount rate, subject to a minimum of 0·50 per cent, on the average amount of its notes and demand drafts in circulation, less the value of the gold reserve and of advances to the Treasury.[1]

DEMAND DRAFTS ISSUED BY THE BANK

In Italy the use made of bank cheques as means of payment has always, for various reasons, been limited. Instead, however, an important rôle has been and is played by bank drafts, in the two forms of the so-called 'circular cheques' (*assegni circolari*) issued by various commercial banks and the special order drafts issued by the central bank.

The Bank's special instruments are the free bank draft (*vaglia cambiario gratuito*) and the free bank cheque (*assegno bancario libero*).[2] Formally these are identical, but while the draft is issued by the branches the cheque is drawn on the Bank's cash offices by its domestic correspondents.

The Bank also executes telegraphic and postal payment orders and carries out, for the benefit of banks and other customers, a large-scale service of orders to credit and of giro transfers. This service is of special importance since the Bank rigidly applies the principle of territorial spheres of responsibility for its own branches in lending operations; since in Italy every bank of any size possesses a regional network commensurate with the volume of its business; and also since the central bank administers the daily clearing service, which in turn is connected with transactions effected on the stock exchanges.

OPERATIONS WITH BANKS AND PRIVATE CUSTOMERS

The Consolidation Act of 1910 imposed various quantitative and qualitative limitations on the central bank's operations with private customers. The quantitative restrictions have since been superseded. Of the qualitative restrictions, some are still in force, namely the rules prohibiting the carrying-out of new mortgage credit operations, the granting of overdrafts, and the investment of funds in securities, valuables, credits or real rights which are not claims on or guaranteed by the state or in any movable or immovable property other than that required for the Bank's offices and services.[3]

[1] Article 1 of the Ministerial Decree of December 31, 1936, and Article 13 of the stamp-duty scale annexed to Presidential Decree No. 492 of June 25, 1953.

[2] Articles 5 and 57 of the Consolidation Act of 1910, Articles 87–105 of Law No. 1736 of December 21, 1933, and Article 41, section 5, of the Statutes.

[3] Articles 58–60 of the Consolidation Act of 1910.

In 1936[1] a further regulation was added forbidding the Bank to discount for private customers. After having given rise to considerable discussion before the war and also in 1946–47, in connection with the drawing-up of the Constitution, this is now one of the Bank's fundamental rules of conduct; of its own accord the Bank has extended its application as far as possible to all operations, including those in respect of which the laws and its Statutes have left it free to choose its customers.

Consequently by far the most important body of customers with which the central bank carries out banking operations consists of public or private credit institutions included in the bank register that was established in accordance with Article 29 of the law of 1936, i.e. in effect all banks and institutions subject to bank supervision (commercial banks, savings banks, pawn banks, rural and artisans' banks and special credit institutions).

Under the Statutes,[2] the portfolio operations which the Bank may perform are:

(*a*) the rediscounting, for credit institutions included in the bank register, of domestic bills and orders;
(*b*) the discounting, for credit institutions and private customers, of Treasury bills and coupons of bonds on which the Bank is permitted to make advances; and
(*c*) the discounting and rediscounting, for banks and private customers, of warrants issued by legally constituted public storehouses and bonded warehouses in respect of goods deposited therein.

The Bank also rediscounts:

(*d*) bills representing agricultural working credits and other similar paper, these bills being taken in from institutions authorized to grant agricultural credit; and
(*e*) bills issued by the storage agencies in order to finance compulsory stocks of agricultural products; these bills are taken in from the financing agencies appointed by the Ministry of Agriculture in agreement with the Bank (commercial banks and special agricultural credit institutions).[3]

The ordinary bills of exchange, bank cheques and all the other types of paper rediscountable by the Bank must be payable within

[1] Article 23, paragraph 1, of the Banking Law and Article 41, section 1, of the Statutes.

[2] Article 41, sections 1–2, of the Statutes and Article 27 of the Consolidation Act of 1910.

[3] As the latter type of bill (storage agency bills), now the only really important type as far as the Bank's lending is concerned, ultimately represents a way of providing funds to the Treasury, it will be dealt with more fully in the next section.

four months and must bear the signatures of two or more solvent persons. The same maximum maturity is a condition of eligibility for discount in the case of Treasury bills, coupons and warrants.[1]

The Bank can also grant banks and private customers four-month advances, in the form of open credits utilizable on current account, against the pledging of:[2]

(1) Italian public debt securities and Treasury bills;
(2) securities guaranteed as to principal or interest by the state;
(3) bonds of mortgage credit institutions and other comparable securities; and
(4) Italian and foreign legal-tender gold coins, gold bars and foreign government securities payable in gold, and also raw and processed silk.

A last form of advance, for which the Statutes contain separate rules,[3] is the system of deferred payments at the clearing houses operated by the Bank. Such deferments are granted to members of the clearing houses against collateral of the kinds accepted for normal advances; the other conditions, too, are identical, except for the period, as deferred payments must be settled from one day to the next or at the latest within four days of the beginning of the deferment. They are granted occasionally in order to enable members of the clearing houses who do not have ordinary advance accounts temporarily to settle adverse clearing balances.

The Bank has now almost entirely given up discounting operations; as for rediscounting, virtually the only type of paper which it still receives in substantial quantities, the so-called 'storage agency' paper, is taken in for reasons which, as will be explained later, have nothing to do with the pursuit by the Bank of a deliberate policy of intervention on the market by means of discounting.

As far as advances are concerned, the only types widely resorted to and of much technical importance are those granted against the collateral of government or government-guaranteed securities. Although permitted by the Statutes, the opening of new accounts in favour of private individuals and companies is a rare occurrence. On the other hand, the credit institutions, which taken as a whole are creditors *vis-à-vis* the central bank, are allowed to make liberal use of the possibility of obtaining credit from the central bank by means of advances. The credit made available in this way is constantly increasing. The limited extent of the changes in its volume, which

[1] Article 45 of the Statutes and Article 27 of the Consolidation Act of 1910.
[2] Article 23, paragraph 2, of the Banking Law, Article 41, section 3, of the Statutes and Article 29 of the Consolidation Act of 1910.
[3] Article 44, paragraph 2, and Article 52 of the Statutes.

are always in the same direction, shows that the gross amount of this form of potential bank liquidity moves in line with the general expansion of the country's economy and of banking services.

The Statutes impose no limitations on the Bank's deposit business: it may accept sums on current account, at interest or without, repayable on demand or at fixed term.[1] By virtue of the powers conferred on him by the Consolidation Act of 1910, the Minister for the Treasury has, however, laid down rules regarding the cases in which interest can be paid on current accounts. In agreement with the Bank, he can also change the rate of interest to be allowed. There are at present three kinds of accounts:

(*a*) free current accounts (*conti correnti liberi*),
(*b*) ordinary time current accounts (*conti correnti vincolati ordinari*), and
(*c*) special time current accounts (*conti correnti vincolati speciali*).

Free current accounts can be opened, for amounts of some importance, in the name of credit institutions, social security and insurance institutions, corporate bodies and private individuals. On the deposits of credit institutions, corporate bodies providing public assistance or serving socially useful purposes and social security and insurance institutions interest is paid at the rate of 0·50 per cent per annum without limit as to amount. The payment of interest on deposits of private individuals or other corporate bodies is forbidden.

Ordinary time current accounts can be held in the name of credit institutions and social security and insurance institutions. At present the Bank pays interest at 1·50 per cent on balances withdrawable at eight days' notice and at 2 per cent on those at fifteen days' notice; it can also accept three-month deposits at 2·50 per cent and six-month deposits at 2·75 per cent.

These accounts were created in 1942 with the immediate object of attracting back to the Bank the notes which had come into circulation as a result of the recurrent waves of withdrawals of bank deposits. During the war and in the immediate post-war period the Treasury was able to make use of this source of finance both by obtaining advances from the Bank on various grounds and through the Bank's purchases of Treasury bills for its own account. An agreement was therefore concluded whereby the great burden of the interest payments on time accounts was to be borne by the government budget, while the Bank undertook to employ the balances in any form which would keep down the note circulation.[2]

[1] Article 42, section 2, of the Statutes and Articles 36–37 of the Consolidation Act of 1910.

[2] Legislative Decree No. 265 of September 21, 1944, and Article 5 of Legislative Decree No. 447 of December 30, 1944.

The provisions introduced in the autumn of 1947 in order to stabilize the value of the lira led to the creation of the special time current accounts and put an end to the Bank's extraordinary advances to the Treasury. The ordinary time current accounts lost the character, which they had had up to then, of instruments for extraordinary financing and at the same time their function was restricted within the present limits.

The special time current accounts contain that part of the banks' compulsory reserves which is held in the form of cash (see pages 219–21). These accounts can therefore be opened only in the name of credit institutions. They bear the same rate of interest as the banks would obtain by investing directly in one-year Treasury bills, which are at present the alternative means of meeting the reserve obligation. As the reasons for which the Treasury took on the interest burden in respect of ordinary time accounts during the war are still valid, the remuneration of special time accounts is still provided from the government budget.

Lastly, there are certain minor operations which the Bank is authorized to carry out, and does carry out very frequently, with its customers. These are the purchase and sale of foreign exchange, the execution of orders to buy and sell public and private securities, and the collection and remittance for account of third parties of sums payable in Italy and abroad.[1] Also in this category are included the cash office services which the Bank's branches perform on behalf of important special credit institutions, which, not having any regional organization of their own, also rely on it for the investigation of lending operations and the placing of and the interest service on their own securities. Finally, the services rendered by the Bank to the banks and the public by holding deposits in safe custody or as collateral, and deposits tied in other ways, are of considerable importance owing to the resultant concentration at the Bank of great quantities of items of value, especially government and government-guaranteed securities.[2]

OPERATIONS WITH THE STATE

The financial relations between the Bank and the Treasury are defined in various legal provisions, which also fix the maximum amount of credit that the Bank may extend in respect of each type of operation, together with the necessary guarantees, the remuneration and the other conditions. There is, however, no fixed limit to the amount of funds which can be invested by the Bank in securities

[1] Article 41, section 6, and Article 42, section 4, of the Statutes.
[2] Article 42, section 1, of the Statutes.

issued or guaranteed by the state.[1] The political basis for the present system as regards the Bank's debtor and creditor relationships with the Treasury was laid in 1947, when measures were introduced to stabilize the lira.

For the carrying-out of its own encashments and disbursements the state makes use of a central office of its own in Rome known as the Central Treasury—which is directly run by the state and performs specifically prescribed functions—and, for the general execution of budgetary operations and certain minor financial services, of the ninety-one Treasury offices which are run by the Bank's branches in all the main provincial towns and in Rome.[2]

The handling of Treasury operations was entrusted to the Bank under Article 9 of the agreement concluded with the government to this end on October 30, 1894. The Bank has continued to carry out these operations ever since by virtue of a series of subsequent regulations. These regulations have laid gradually increasing stress on the public importance of this function, which the central bank has to perform in harmony with all its other functions. The extensions and any amendments to the conditions governing these operations are normally made by means of supplementary agreements.[3]

In practice the function of government cashier is not confined, as in other countries, to the centralization, custody and transfer of public funds but extends to the actual execution of all payment orders issued by government departments, the collection of all sums which are owed for any reason to the state, the acceptance, safe custody and restitution of deposits of securities and cash on behalf of the state and of government departments, and the sale and redemption of Treasury bills and other government securities and the interest service thereon.

The whole movement of funds and securities connected with collections and payments on behalf of the state is thus reflected immediately and exclusively in the central bank's cash holdings, except for a minor proportion which is reflected in those of the Central Treasury.

The wide margin of credit which the Bank is legally obliged to grant to the Treasury makes it unnecessary for the latter to hold cash in hand. It was in fact laid down in 1948 that the Treasury current account could be overdrawn to the extent of 15 per cent of the total of the original estimates of actual budget expenditure and of the subsequent supplementary estimates approved by Parlia-

[1] Article 41, section 4, of the Statutes.

[2] Article 43 of the Statutes and Articles 40–43 of the Consolidation Act of 1910.

[3] The most recent extension—until December 31, 1970—was authorized by Article 1 of Law No. 1562 of December 22, 1960.

ment.[1] This system has been found in practice to leave a sufficient margin to meet all the Treasury's temporary and exceptional requirements. If, however, the 15 per cent limit is reached and the necessary cover is not provided immediately, the Bank has to suspend payments—after giving twenty days' notice—until such time as the current-account balance is brought back within the prescribed margin.[2]

Another type of operation in respect of which the initiative formally lies with the government is that of investments in securities for account of the Treasury. The Treasury has in fact reserved the right, since the introduction of the special time current accounts for the banks' compulsory reserves, to require the Bank to invest the funds paid into these accounts by the credit institutions in government securities, for the most part Treasury bills, the interest on which is repaid to the state.

An important service connected with the handling of Treasury operations is that of issuing Treasury bills. Every year the budget law gives the Minister for the Treasury authority for the issue of an unlimited amount of bills. These are at present sold to credit institutions on the basis of a monthly quota which takes into account the Treasury's cash requirements and the liquidity of the market. Bills required by the banks for their compulsory reserves are allotted to them at the basic rate of 3·50 per cent per annum, payable in advance, while the remainder, if any, of the monthly quota, which may be taken up for normal investment purposes, is allotted to the highest bidders, if necessary on a *pro rata* basis. Firms and individuals can purchase bills from the banks within the limits of available supplies; bills may also be bought and sold at the counters of the Bank of Italy at the Bank's discretion.[3]

The credit institutions are the chief buyers of bills. They use them for the temporary investment of funds, as collateral for advance accounts and, above all, to constitute their compulsory reserves, as an alternative to cash payments into the special time current accounts. In addition to the regular rate of interest—which is seldom altered, and usually only when there is a change in the discount rate—the credit institutions receive a special extra remuneration, at present amounting to $\frac{1}{4}$ per cent, on Treasury bills purchased to meet their reserve requirements.[4] This is paid separately from the interest and is

[1] Article 2, paragraph 1, of Legislative Decree No. 544 of May 7, 1948.

[2] Article 2, paragraph 2, of Legislative Decree No. 544 of May 7, 1948.

[3] At present only twelve-month bills are issued, which, as already mentioned, bear interest, payable in advance, at 3·50 per cent per annum (actual yield, 3·63 per cent).

[4] Articles 1–4 of Legislative Decree No. 362 of April 14, 1948, and Article 5 of Law No. 322 of May 19, 1950.

intended to bring the yield on compulsory reserves held in Treasury bills into line with that on reserves held in cash.

The Statutes state that the Bank may directly 'invest sums in securities issued or guaranteed by the state',[1] and it does in fact always keep in its portfolio a certain—not very large—amount of such securities (at the end of 1962 about 7 per cent of the note circulation). The Bank's holdings of government securities are generally the result not so much of any deliberate intervention on the market as of occasional operations, such as the repayment or recovery of loans, sales by the Italian Exchange Office, etc. A further part of the government and government-guaranteed securities held is attributable to the investment of moneys set aside for special purposes, e.g. statutory reserves, depreciation reserves and staff pension funds.

An operation which from many points of view may be regarded as representing an acquisition of government bonds is the rediscounting of storage agency bills for the credit institutions participating in the financing of compulsory stockpiles of agricultural products (at present wheat, together with very small amounts of rice and hemp). A bill presented to Parliament in 1959 provides, however, for the gradual conversion of the amount of such paper in circulation into special ten-year interest-bearing non-discountable Treasury certificates, to be redeemed out of ordinary budget funds over a number of years.

The fundamental change in the aims of the compulsory wheat-stockpiling system during and since the war, from a measure protecting consumers to an instrument for protecting producers, has caused the rediscount obligation to become the means whereby the state, financially responsible for the operating losses of the stockpiling system, transfers to the Bank a liability which it is unable to meet out of current budget allocations. Thus, despite the repayments made, there has accumulated a large amount of arrears, which will inevitably have to be passed on to the budgets of future financial years and meanwhile remains in the portfolios of the commercial banks and the central bank.

The temporary and extraordinary advances to the Treasury are a form of financing of the state which fell completely into disuse when the stabilization measures were adopted in the autumn of 1947. So long as the present arrangements remain in force, the Bank could be obliged to resume granting them only by virtue of a special law determining the amount thereof.[2]

An indirect form of lending to the state which has been of considerable importance comparatively recently is the lending of foreign

[1] Article 41, section 4, of the Statutes.

[2] Article 1 of Legislative Decree No. 1490 of December 24, 1947.

exchange to the Treasury by the Italian Exchange Office out of the foreign exchange resources it had obtained by drawing on its current account with the central bank. In accordance with appropriate legislative provisions, the Treasury used these foreign exchange resources, especially in the period 1952–54, partly to make loans to the Italian Industrial Credit Institute (Istituto Mobiliare Italiano—I.M.I.) for relending to private borrowers, and partly to finance the acquisition of government commodity stocks and equipment. Repayment is made out of the proceeds of the sale of the goods, out of the funds received back in respect of the loans granted by the I.M.I. and by the issue of Treasury bills.

Another important function normally performed by the Bank is that of acting as head of the issuing syndicate formed from among the credit institutions for the purpose of placing medium-term government securities and, in some cases, government-guaranteed securities. On such occasions the Bank, in addition to agreeing with the Treasury on the most suitable timing and terms for the subscription or conversion, arranges the distribution among the members of the syndicate of all or part of the amount to be issued, laying down the payment terms, the commissions and the penalties.

FOREIGN EXCHANGE CONTROL AND RELATIONS WITH THE ITALIAN EXCHANGE OFFICE

The Italian Exchange Office, a public body with its Head Office in Rome, was created in 1945 to continue the work of the National Foreign Exchange Institute. Although subject to the supervision of the Ministry of the Treasury, the Office is independent in its administration and accounting and is entrusted by law with the monopoly of dealings in foreign exchange and all other international means of payment, including monetary gold, the supervision of the observance of the foreign exchange regulations and the administration of the official foreign exchange reserves.[1]

As already mentioned, the Office can for various reasons be regarded as an institution affiliated to the central bank. Although it maintains direct relations with Italian and foreign banks, the Office carries out most of its operations through the Bank's branches, which act as its agents. Its initial capital (100 million lire) was provided by the Bank, and the Italian currency which it needs in order to acquire foreign exchange is supplied to it through a current account at the Bank's Head Office, on which the Office has up to now been able to draw without limitation as to amount. The advances

[1] Articles 1 and 4 of Legislative Decree No. 331 of May 17, 1945, and Article 1, paragraph 2, of the Office's Statutes, approved by the ministerial decree of February 25, 1946.

are arranged by mutual agreement, there being no law requiring the Bank to grant credit to the Exchange Office.

From the administrative point of view the Bank occupies a dominating position in the running and technical operation of the Office. The Governor is responsible, *ex officio*, for the 'overall management' of the Office and for presiding over its Board of Directors, which is composed of seven members, of whom one is an official of the Bank, two are appointed by the Governor and the remainder are selected by the government from among persons with expert knowledge in this field. Within the limits of the powers conferred upon it by law in the foreign exchange field, the Office can, however, give instructions to the central bank and the other banks in their capacity as its agents.

In the foreign exchange sector the Bank performs two main functions. By virtue of powers delegated to it by the ministries or the Office, it grants permits and sees that foreign exchange measures are duly carried out. This activity is particularly important in the major centres, where the Bank is solely responsible for the supervision of certain types of transactions, as well as being concerned with many others in cases which are not within the competence of the authorized banks. In addition, it has an operative rôle of its own, which, while very limited as regards commercial transactions and operations in any way connected with the granting of credit, is of far-reaching importance in the case of some non-commercial operations. For example, the Bank is the central body responsible for the foreign exchange operations of non-authorized credit institutions and money-changing offices, and also for payments on behalf of foreign governments and international institutions, settlements with foreign central banks and some monetary transactions with the central offices of the major Italian banking institutions.

SUPERVISION OF THE BANKING SYSTEM

The provisions establishing the bank supervisory system were issued in 1926[1] and were primarily designed to protect depositors by laying down definite rules of conduct common to all banking institutions. The carrying-out of the supervision was entrusted directly to the central bank (which had become at about the same time the sole note-issuing body). The Bank then created, at its central and regional offices, the Bank Supervisory Department, which at present, with greatly extended functions and means of action, carries out particularly important and delicate tasks.

[1] Provisions for the protection of savings contained in Decree-Laws No. 1511 of September 7, 1926, and No. 1830 of November 6, 1926, converted into Laws Nos. 1107 and 1108 of June 23, 1927.

The law of 1936 did not essentially alter the existing situation. It declared that the acceptance of savings and the carrying-out of credit operations were functions of public importance (Article 1, paragraph 1). In addition, it confirmed the principle of making them subject to special legal regulations and to supervision by a governmental body, the Inspectorate for the Protection of Savings and for Credit Operations,[1] which was presided over, *ex officio*, by the Governor of the Bank.[2] During the war the Inspectorate, which in fact had always mainly relied on the technical services and staff of the Bank's Supervisory Department, was abolished[3] and its functions, together with those of its head, were transferred to the reconstituted Ministry of the Treasury. However, in performing its supervisory functions the Ministry continued—as was expressly provided for in the law—to make use of the Bank as its technical agent.

Finally, the decree of 1947 allocated the functions originally assigned to the Inspectorate directly to the Bank, in its capacity as the central bank, and entrusted again to the Governor those formerly performed by the head of the abolished Inspectorate.[4] At the same time it re-established the Committee of Ministers provided for by the Banking Law, under the new name of Interministerial Committee for Credit and Savings, adapting its composition to the new political system and restoring to it the functions which since 1944 had been carried out by the Minister for the Treasury.

The power to issue the ordinances regarding credit and savings provided for by the law of 1936 and to take any other supervisory measures is entrusted to the Minister for the Treasury, who exercises it in accordance with the resolutions of the Committee or, if there is no particular urgency, after consultation with the Committee, whose meetings are as a rule held once a month under the chairmanship of the Minister himself. Directives of a general and policy nature are given in appropriate Committee resolutions; the provisions which the Governor of the Bank is empowered to introduce are published by him in the form of ordinances; the Bank issues its own authorizations and notices through the branches responsible for the regions in question.

The decree-laws of 1926 applied primarily to the commercial banks, except for a few provisions which also had to be observed by the savings banks and special credit institutions. The law of 1936 extended the application of the rules to all institutions granting short-term credit and to savings banks and some special credit institutions, concentrating the supervisory functions previously

[1] Article 2, paragraph 1, and Article 11 of the Banking Law.
[2] Article 12, paragraph 2, of the Banking Law.
[3] Article 1 of Legislative Decree No. 226 of September 14, 1944.
[4] Article 2, paragraph 1, of the decree of 1947.

performed by different bodies in accordance with special rules exclusively in the hands of the central supervisory authority.[1] Finally, immediately after the war, this supervision was extended, without distinction, to all institutions engaged in accepting savings and granting medium and long-term credit.[2] Furthermore, by virtue of special legal provisions, the Bank keeps a watch on the activities of finance companies and of institutions which grant credit or carry out stock exchange operations or operations on the foreign exchange market without receiving savings, as well as those of financial, industrial or commercial enterprises which accept deposits from their customers, employees or affiliated bodies without granting credit.

RELATIONS WITH THE CAPITAL MARKET

The Bank does not operate in the open market with a view to attaining either short, medium or long-term monetary policy aims. Although it is allowed to invest funds in government or government-guaranteed securities, such direct investments are limited and do not appreciably influence the market. Nevertheless, the Bank is in constant touch with the capital market in various ways and is therefore able to follow its development closely and to exert a certain influence so as to ensure that its trend does not run counter to that of the money and credit markets.

Some of these links are the direct or indirect result of the Bank's business relations with the state, the banks and other financial institutions, to which reference has already been made. Others arise out of the functions performed by the Bank in the fields of foreign exchange and bank supervision. Its close relations with the Italian Exchange Office, for instance, enable it to keep constantly abreast of what is going on and to participate in all important decisions relating to movements of capital—public, banking, or private—to or from foreign countries and to have a hand in the preparation of government measures concerning financial dealings with foreign countries. The Bank must be consulted with regard to issues of Italian securities abroad and of foreign securities in Italy, which have to be authorized by the Minister for the Treasury.[3]

The bank supervisory system, originally limited to a few of the special credit institutions, was duly extended in 1946 to all existing institutions and to the numerous institutions which, in whatever

[1] Articles 5, 6 and 41 of the Banking Law; the Bank must also be consulted concerning questions relating to the Central Post Office Savings Fund (a special institution under the control of the Ministry of the Treasury) and the banking activities of the post offices.

[2] Article 1 of Legislative Decree No. 370 of August 23, 1946.

[3] Article 46 of the Banking Law and Article 13 of Decree-Law No. 476 of June 6, 1956.

form, were subsequently to be created, the object being to enable the Bank to keep a watch over the functioning of the whole credit and savings system. In towns with stock exchanges the managers of the Bank's branches attend meetings of the stock exchange committees as *ex officio* members.

A means of direct control which was made available to the central bank by the Banking Law[1] is the authorization which the Bank has to give for all issues, public or private, if they are made through the intermediary of institutions subject to bank supervision or if the securities are to be listed on the stock exchange. By its nature this power of authorization, which applies also to issues of shares and bonds of banks and special credit institutions (except for mortgage bonds), forms part of the function of supervising the banking system. Its importance from the point of view of policy is due to the fact that at the same time the Minister for the Treasury is responsible for authorizing, after consulting the Interministerial Committee, the formation of companies, capital increases against payment and issues of bonds exceeding the amount of 500 million lire.[2] Where both authorizations are necessary—as is usually the case—the examinations of the two authorities are carried out separately, but there is only one actual authorization, and that is issued by the Minister after consultation with the Committee.

An activity of the Bank which is of particular concern to the capital market, apart from being of considerable importance for operations with the banking system, the state and the Italian Exchange Office, is the running of the clearing houses and offices.[3] Established in the nineteenth century, the clearing houses were at first run by the Bank in some towns on behalf and under the supervision of the Chambers of Commerce. Since 1926 their operation has been entrusted exclusively to the Bank, and since 1947 the Bank has also been responsible for regulating and supervising them—functions which were previously assigned to other bodies.

V

MONETARY POLICY

THE FRAMING OF MONETARY POLICY

The legislation now in force makes it clear beyond doubt that the formulation of monetary and credit policy is the responsibility of

[1] Articles 44 and 45 of the Banking Law.

[2] This authorization was temporarily introduced in 1935 and subsequently extended several times; now, by virtue of Law No. 428 of May 3, 1955, it is permanent.

[3] Article 136 of the Consolidation Act of 1910 and Article 44 of the Statutes.

the government. If there was any uncertainty in the past, this was ended when the new Constitution entered into force. Reproducing a passage of the law of 1936, the Constitution solemnly declared that 'the Republic shall encourage and protect saving in all its forms; it shall regulate, co-ordinate and supervise the granting of credit'.[1]

Since the amendment of the Banking Law in 1947, there are now two kinds of functions connected with the co-ordination and control of monetary, credit and foreign exchange matters. They are entrusted to two distinct authorities. Policy-making functions are assigned to the Interministerial Committee for Credit and Savings, executive and supervisory functions to the Minister for the Treasury and the Bank.

The Committee contains most of the members of the government in power. It is therefore able to issue directives for action in the field of money and credit in harmony with general economic policy, of which, owing to its high level of political awareness, it is capable of giving at all times the most authentic interpretation. At the same time, as the members of the government take part in the decisions of the Committee, they are corporately responsible for these to Parliament. The Minister for the Treasury, apart from being chairman of the Committee, possesses by virtue of his office wide regulative powers which are integrated with his other functions, especially that of administering the government's finances.

In view of its special qualities in the technical field, the primary executive body is the Bank. The latter possesses certain regulative powers and has the supervisory functions assigned to it by the law. The implementation of the Committee's policy directives concerning money and credit is also entrusted to the Bank, with a wide measure of discretion as to how they are to be applied to the banking system. The supervision is exercised completely independently, in accordance with the general rules of conduct and the decisions of the Committee; the latter, when they relate to specific cases or matters connected with regulations, are approved by the Minister for the Treasury.

Lastly, since the Governor takes part in the meetings of the Committee, in connection with whose activities the Bank in most cases carries out the necessary investigations, and in view of the extent to which the Bank is consulted beforehand, it is possible for the Bank to take the initiative with regard to the adoption of measures and decisions by the Committee; indeed, this possibility is of no little practical importance and appreciably reduces the chances of disagreement.

[1] Article 47, paragraph 1, of the Constitution, which came into force on January 1, 1948.

THE INSTRUMENTS FOR CONTROLLING MONEY AND CREDIT

The means at the Bank's disposal for achieving its aims can be divided into main and subsidiary ones. The main instruments are essentially designed to achieve monetary equilibrium in the market by regulating bank liquidity. They consist of:

(1) the Bank's freedom to decide on the extent to which recourse may be had to it as the source of credit of last resort, this being the form assumed in Italy by the classical instrument of discount policy;
(2) the obligation imposed on the banks to maintain a certain ratio between their capital resources and their deposits and to invest excess amounts in a prescribed form, which represents a special system of compulsory bank reserves; and
(3) the policy pursued with regard to the use of the foreign exchange reserves, together with the Bank's power to regulate the volume of the banks' short-term foreign indebtedness and to lay down the conditions governing the reinvestment of their foreign exchange holdings.

Subsidiary instruments which are fairly regularly employed are:

(1) control over the granting of credits for amounts exceeding one-fifth of the capital resources of the bank providing them, which entails the prior examination of all bank loans, including those up for renewal, that are large enough to be of economic importance;
(2) its power, for purposes of banking supervision, to grant or withhold permission for issues of private securities and issues of the special credit institutions, taken in conjunction with the authorization given in the light of market conditions by the Minister for the Treasury;
(3) the part it plays in shaping policy as regards issues of medium and long-term government securities, which, in view of the characteristics of the Italian market, represents a partial substitute for the open-market operations carried out elsewhere; and
(4) moral suasion applied not only to the large commercial banks but also to the smaller banks and the special credit institutions.

The effectiveness of the three main instruments is dependent on certain permanent safeguards built into the system during the first phase of post-war monetary policy, the purpose of which was to

ensure that monetary equilibrium could not be impaired by autonomous external factors to an extent exceeding the Bank's compensatory powers.

An essential rôle is played in this connection by the protective legal and constitutional provisions introduced in 1947–48 to eliminate the possibility of automatic and privileged recourse to central-bank credit for the purpose of covering increases in public expenditure. These safeguards have already been described in the previous section.

Apart from the financing of compulsory stockpiles, the banks can obtain credit from the central bank either by means of ordinary rediscounting or by drawing on current advance accounts. The cost is about the same, but the second is the only method to which they regularly have recourse. Ordinary rediscounting—except in the case of certain local banks of little economic importance—is not resorted to, because it is more cumbersome than drawing on advance accounts and because external factors have caused it to be gradually abandoned.

The Bank influences the volume of credit obtained by the banks not by varying the interest rate but by limiting at its own discretion the facilities extended to them. Generally speaking, credit is granted liberally and at short term only for recognized temporary cash requirements and seasonal needs—and never to help the banks to meet their compulsory reserve obligations.

Alterations in the discount rate, which are usually accompanied by similar changes in the rates on advances, special time accounts and Treasury bills, have only a very limited influence on the banks' recourse to central-bank credit. In fact, in Italy the availability of central-bank credit has for some years been more important than its cost. The only important effect of changes in the discount rate is the psychological one they can exert on the banking system and the market, giving as they do a true and clear indication of the Bank's intention to pursue and implement a certain line of monetary policy with all the means at its disposal.

It should be pointed out in this connection that the official discount rate, like the other creditor and debtor rates applied by the Bank, is changed, on the recommendation of the Governor, by a decree of the Minister for the Treasury.[1] The Bank's lending rates have always been well below those charged by the commercial banks to

[1] Articles 28, 30, paragraph 2, and 37, paragraph 2, of the Consolidation Act of 1910, Article 1 of Decree-Law No. 1284 of November 23, 1914, Article 5, paragraph 2, of Decree-Law No. 1377 of June 17, 1928, and Article 25, paragraph 4, of the Statutes. The Minister's constitutional powers also include that of fixing the remuneration of Treasury bills and of compulsory bank reserves, as well as the terms applying to deposits held with the postal administration and to credits granted by the Central Post Office Savings Fund.

their customers; and the penal effect of the interest rate on advances is very mild, since the yield of the government securities deposited as collateral is on the average higher than or at least equal to the rate of interest charged by the Bank.

The compulsory bank reserve is an essential instrument for the control of money and credit by the central bank. It is particularly effective because it directly and continuously influences a large proportion of the banking system's liquidity reserves and thus its power to create new credit. At the same time, the way in which it operates after the constitution of a blocked deposit gives the Bank's balance sheet a considerable degree of flexibility. There are two reasons for this. On the one hand, it enables the Treasury to absorb part of any increase in bank money, thus in normal times avoiding permanent recourse by the government to central-bank credit. On the other hand, it makes it possible for the Bank effectively to sterilize excess reserves.

Because of the apparently rigid formal basis of the system of compulsory bank reserves, the variability of its final effect on the level of liquidity is not immediately evident. The relationships between bank assets and liabilities, which are its outward expression, are not changed from time to time, as in other countries, in accordance with the aims then being pursued by the central bank in its policy of ironing out fluctuations in liquidity. Nevertheless, in view of what is done with the reserves constituted by the banks in the form of cash and of the repercussions of increases or reductions in the proportion actually sterilized by the central bank, the operation of the whole mechanism results in a fairly rapid adjustment of total liquidity to the needs of the situation.

The reserve requirement as a specific measure for controlling liquidity originated in the instructions which the Bank issued to the other banks in August 1947 at the direction of the Interministerial Committee. Power to issue instructions had originally been conferred on it by the provisions of 1926 and had been confirmed by the law of 1936,[1] with the primary object of safeguarding bank solvency.

The instructions of August 1947 essentially reproduced the clause of 1926, while, however, considerably increasing its effect as regards future rises in deposits. In practice it was laid down that 20 per cent of the amount by which the commercial banks' deposits exceeded ten times their net capital resources must be invested—subject to an upper limit of 15 per cent of deposits at the end of September 1947, excluding deposits in foreign exchange and inter-bank accounts—in government securities or deposited in cash in special blocked accounts ('special time current accounts') at the

[1] Article 5, paragraph 2, of Decree-Law No. 1830 of November 6, 1926, and Article 32, section f, of the Banking Law.

Bank. The proportion to be invested in respect of increases in deposits occurring after October 1, 1947, was, however, to be 40 per cent, subject to the proviso that this should not result in an overall reserve ratio of more than 25 per cent of total deposits. As from January 1962 the upper limit was lowered to 22·5 per cent and a lower limit of 10 per cent—payable entirely in cash—was introduced.

These rules form the basis of the compulsory reserve requirements, whose actual incidence up to the end of 1961 was in the region of 23–24 per cent of the amount of the deposits subject to the obligation; at the end of 1962 it was about 21 per cent. A check is made each month in the light of the returns which all the credit institutions have to send to the Bank for statistical purposes; if the rules are not being complied with, the institution in question is called upon to correct its position as quickly as possible.

Since January 1953 the only way of making the blocked deposits other than in cash has been by lodging Treasury bills. Medium and long-term government and government-guaranteed securities, which the central bank accepts as collateral for advance accounts and which could previously be freely used for the blocked deposits, can no longer be employed for the latter purpose. The equalizing of the yield of twelve-month Treasury bills with that of the special blocked accounts has been achieved by the state's making a special compensatory payment on bills subscribed by the credit institutions. Since August 1958, in view of the increased volume of short-term operations carried out by the savings banks, as a result of which they are coming more and more to resemble commercial banks, the reserve obligation has been partially extended to these institutions.

In general, the deposits held with the banking system have risen steadily since 1947, so that the reserve requirement has for the most part necessitated, from year to year, additional deposits of bills or cash. As the credit institutions have, within the prescribed limits, a choice between the two forms and know fairly precisely the seasonal variations in their own deposits, they endeavour to co-ordinate the maturities of the bills which they deposit with the likely withdrawals, using the cash amounts which become available at the maturities, as required, to replenish their branches' funds or to add to their open accounts at the Bank.

Although of great importance for the positions of individual institutions, the fact that the banks can change the composition of their compulsory reserves is of no practical overall significance. This is because the Bank can offset any such changes by increasing or decreasing its investments in Treasury bills made with bank reserves deposited in cash; the limits to its compensatory action are set in

the first case by the total amount of reserves deposited in cash and in the second case by the amount of its previous investments. As there is no organized market in Treasury bills, the operations are carried out almost exclusively with the Treasury, by means of new subscriptions and total or partial renewals of bills previously acquired. The level of the Bank's investments for account of the Treasury at any given moment depends on conditions on the money market and on the state of the Treasury finances. Consequently the proportion of compulsory bank reserves actually sterilized depends not only on the preferences of the banks themselves as between cash and Treasury bills but also, in particular, on the action taken by the Bank in agreement with the Treasury.

The measures adopted in 1947 to regulate the Treasury's recourse to the Bank and the state of bank liquidity would have left a gap in the defences constructed in the interests of monetary stabilization if at the same time means had not been created of countering the inevitable fluctuations in foreign payments.

In the situation then existing the formation of a foreign exchange reserve was dictated primarily by the wish to avoid dangerous interruptions in the flow of imports necessary for reconstruction. Actually the fact that this fundamental aim had been given precedence over other important objectives was a great help to the country when it had to cope with the wide fluctuations in foreign payments which occurred during and after the Korean war.

Subsequently, part of the reserves was again used to stimulate domestic investment. The Italian Exchange Office placed at the disposal of the Treasury substantial amounts of foreign exchange, a large proportion of which was lent to private borrowers on preferential terms to finance extraordinary imports of capital goods, thus spreading out over a longer period the burden imposed by these on the financial resources of the enterprises concerned.

More recently, the official reserves having been considerably augmented as a result of the favourable trend of current foreign transactions and international capital movements, these resources have been used more particularly in order to regulate bank liquidity. At first the banks were given increased opportunities of accumulating foreign exchange; in addition, the time-limits for the compulsory surrender of exporters' earnings were extended and the ceilings on short-term indebtedness to foreign banks were raised, the main object of all these measures being to stimulate imports and domestic activity through an expansion of foreign exchange credits granted by the banks on more favourable terms than those applicable to credits in lire.

Later, the banks' foreign indebtedness having become excessive, producing adverse effects on market liquidity and causing an

artificial growth in the official reserves, use was made of the latter to supply the banks with the funds necessary to balance their short-term positions *vis-à-vis* foreign countries either by reducing their drawings on credit lines or by increasing their short-term foreign lending.

Two powers of authorization possessed by the Bank in its capacity as the body responsible for supervising the banking system have been and still are of considerable importance: these are the prior authorization procedures for loans exceeding one-fifth of the lending bank's capital resources and for issues of private securities by banks and of bonds by special credit institutions.

Although the one-fifth limit varies greatly from one institution to another and rises as the banks' capital resources increase, this authorization requirement has enabled, and still enables, the Bank to exert a selective and restrictive influence on credit-granting, depending on the market situation and the object of the operations in question. While respecting the principle that the assessment of risks and of all other factors of a banking character is entirely a matter for the discretion of the institution concerned, the Bank has made use of this instrument to prevent, for example, the financing of speculative stock-building during boom periods or to ensure that short-term credits shall not be used for the long-term financing of fixed investments. The same objects can be achieved by selectivity in authorizing the granting of credits by banks outside the territorial area in which they are normally allowed to operate.

The fact that the Bank must give its permission before securities can be issued through the banks or listed on the stock exchanges has already been referred to on page 215. From the policy point of view, it should be mentioned that the decision to grant an authorization—which is arrived at in the great majority of cases by the dual procedure involving both the Bank and the Ministry, after consultation with the Interministerial Committee—is based not only on the special considerations relating to the case in question but also on an examination of the general market situation. Thus, depending on whether funds are plentiful or scarce, the granting of permits can be accelerated or delayed, taking into account capital movements from and to foreign countries and issues being made by the state, the special credit institutions and private borrowers.

The Bank also exercises a similar influence by the active part it plays in the issue of government securities by heading the banking syndicate which places them. In fact, as the central bank, it can control the issuing of public securities with a view to reabsorbing liquidity surpluses of a seasonal nature (e.g. at the beginning of the year) or of foreign origin (e.g. in the summer), or in order to consolidate possible excess amounts of securities in the banks'

portfolios by selling them securities not utilizable for reserve purposes; in such cases government issues represent the only kind of intervention on the open market which at present seems useful and feasible in Italy.

Thus, as can be seen from the foregoing, the Bank's intervention is generally the result of its judgement of market symptoms, and the instruments at its disposal are relatively simple, centralized and mostly not of a hard-and-fast institutional character. It is therefore very important for the exact interpretation of Italian monetary and credit policy at any given moment to know the particular conditions governing the supply of funds and the general equilibrium of the market. The Bank's means of intervention have, in fact, been adapted over time to general circumstances and structural factors so as to make them as effective as possible.

This also explains why, in order to attain its aims, the Bank has always placed great reliance—and the result has fulfilled its expectations—on the active co-operation of the commercial banks and other credit institutions, achieved through personal relationships and particularly close contacts between the men in charge of the central bank and the leaders of the banking world. This co-operation in fact represents an instrument of decisive importance in cases where the use of the other instruments is found to have little or no effect.

RECENT DEVELOPMENTS

In the course of the last two years the measures taken by the Italian monetary authorities have been more active and more varied than in the past. New instruments have been devised and introduced and existing instruments have been used more often and with greater flexibility.

The greater maturity achieved by the Italian economy in the last ten years of intense and systematic development has, in fact, made it necessary for the means at the disposal of monetary and financial policy to be refined and amplified so that the process of development can be continued and its fruits put to good use. It has also necessitated the initiation of a process of gradual reform of structural and institutional features so as to adapt them to the growth of the economy and to the greater complexity of monetary and financial developments.

This new policy has taken three different directions. Firstly, by affecting the banks' net foreign exchange position it has aimed at preventing the credit system from becoming the channel for movements of short-term capital into and out of Italy, with disturbing effects on the distribution of international liquidity and on the process of internal liquidity formation.

Secondly, an attempt has been made to distinguish more sharply between ordinary credit and that granted by the special credit institutions, and various steps have been taken with a view to maintaining and increasing the capacity and effectiveness of the capital market. The aim has been, in particular, to create the conditions necessary for transfers of funds from one lending category to another and to channel funds to uses thought to be more in the general interest. In this context, particular importance attaches to the measures taken to make the markets, and the interest rates applied on them, more responsive to monetary policy.

Lastly, certain institutional reforms have been carried out, including the very important one aimed at creating an organized money market, on which funds can be passed between the Treasury, the central bank and the credit institutions at variable prices depending on the interplay of supply and demand. The object of this reform was, *inter alia*, to improve the links between the short-term and long-term markets and to make the rates quoted on the two markets more closely interdependent. The change in the system of issuing ordinary Treasury bills, by which the issuing of unlimited amounts at a fixed price has been replaced by the issuing of fixed amounts at variable prices, depending on the Treasury's cash requirements, was one of the most notable measures on the way to the gradual organization of a money market.

ANNEX
END-OF-MONTH RETURN AND EXPLANATORY NOTE

BANCA

END-OF-MONTH

December

Assets	In millions of lire
1. Gold	1,000,000
2. Cash in hand	12,109
3. Domestic bills of exchange	615,413
4. Bills for collection	269
5. Advances	260,374
6. Deferred payments	12,015
7. Foreign exchange balances abroad	63,479
8. Italian Exchange Office	2,146,041
9. Government or government-guaranteed securities	243,652
10. Premises	—
11. Miscellaneous debtors	132,545
12. Extraordinary advances to the Treasury	485,000
13. Miscellaneous services for account of the government	—
14. Expenditure	49,238
	5,020,135
15. Securities and other valuables deposited	4,845,362
Total	9,865,497

D'ITALIA

RETURN

1962

Liabilities	In millions of lire
16. Note circulation	3,234,450
17. Bank drafts, cashiers' cheques and other sight liabilities	42,864
18. Free current accounts	122,282
19. Time current accounts	987,826
20. Miscellaneous creditors	237,886
21. Treasury current account	320,311
22. Miscellaneous services for account of the government	17,716
23. Capital	300
24. Ordinary reserves	4,320
25. Extraordinary reserves	2,325
26. Receipts	49,855
	5,020,135
27. Depositors	4,845,362
Total	9,865,497

EXPLANATORY NOTE ON THE RETURN

ASSETS

1. GOLD

The Bank's gold holdings are valued on the basis of 703,297·396 lire per kilogramme fine, in accordance with the parity fixed by Decree-Law No. 14 of January 28, 1960.

2. CASH IN HAND

Includes Treasury notes, coin, postal cheques, etc., but does not include the Bank's notes, which are deducted from the amount of the note issue.

3. DOMESTIC BILLS OF EXCHANGE

Comprise ordinary domestic bills and those relating to the official stocks of agricultural produce rediscounted at the Bank by credit institutions, and other bills and securities discounted (warrants, Treasury bills and securities against which the Bank can make advances and the coupons pertaining thereto, provided that they are within four months of maturity).

5. ADVANCES

Comprise advances effected against the pledging of securities and other assets and goods specified by law (securities issued by the government, the special credit institutions and similar bodies).

6. DEFERRED PAYMENTS

These are advances, not renewable after the fourth day, granted by the Bank to members of the clearing houses managed by it against securities of the kinds accepted for advances and deposited with the said clearing houses.

7. FOREIGN EXCHANGE BALANCES ABROAD

This item represents the countervalue in lire of the amounts available abroad in the form of foreign exchange balances and other assets held in the name of the Bank.

8. ITALIAN EXCHANGE OFFICE

This item is made up of (*a*) advances to the Treasury, which comprise foreign exchange allocations for purchases of government supplies, machinery and equipment and for the granting of loans to the private sector via the special credit institutions; and (*b*) gold and foreign exchange, comprising the remainder; this may not correspond to the foreign exchange holdings of the Italian Exchange Office, which are the counterpart not only of funds supplied by the Bank but also of the Office's own funds and are influenced by the transactions effected by the Italian Exchange Office with banks and the private sector.

11. MISCELLANEOUS DEBTORS

Include, in addition to certain minor items, the securities (mostly government paper) in which the reserves and the various provisions shown under 'Miscellaneous creditors' are invested, and, up to January 1960, the difference between the purchase price of the Bank's gold holdings and the price at which they were shown in the balance sheet (21,381·227 lire per kilogramme). This series was reconstituted in December 1960 after the creation of the new item 'Italian Exchange Office'.

LIABILITIES

16. NOTE CIRCULATION

Represents the amount of bank-notes issued, net of those in hand.

17. BANK DRAFTS, CASHIERS' CHEQUES AND OTHER SIGHT LIABILITIES

Comprise promissory notes, current-account cheques, free bank cheques drawn by correspondents, telegraphic payment orders, etc.

18. FREE CURRENT ACCOUNTS

Consist of credit balances on current sight accounts, both interest-bearing and non-interest-bearing, held in the name of private customers, credit institutions and corporations; they include the special 'M' accounts (into which the credit institutions have to pay amounts in respect of foreign-owned lira accounts held with them) and funds derived from the sale of U.S. agricultural surpluses.

19. TIME CURRENT ACCOUNTS

Comprise various categories of accounts, including foreign correspondents' lira accounts (*loro* accounts) and the credit institutions' compulsory reserves.

The banks' compulsory reserves can be paid into special interest-bearing current accounts at the Bank of Italy or invested in Treasury bills (prior to January 10, 1953, they could also be invested in medium or long-term securities issued or guaranteed by the government) to be deposited with the Bank, in the following proportions:

(*a*) 20 per cent of the amount by which the deposits of the bank in question exceeded ten times its own funds as at September 30, 1947, subject to a maximum of 15 per cent of deposits;

(*b*) 40 per cent of the amount by which deposits have increased in relation to their figure on September 30, 1947, excluding, in cases where a bank's capital has been raised, the free amount equal to ten times its own funds;

(*c*) up to December 31, 1961, the reserves constituted had not to exceed 25 per cent of deposits; as from January 1962 the upper limit was reduced to 22·5 per cent and a lower limit of 10 per cent—payable entirely in cash—was introduced.

Since September 1, 1958, savings banks and first-class pawn banks have also had to hold reserves equal to 20 per cent of the increase in their deposits. These reserves can be deposited with the Bank of Italy or with the Savings Banks' Credit Institute; in the latter case the Institute must pay half the reserves to the Bank of Italy and observe certain rules in investing the other half.

21. TREASURY CURRENT ACCOUNT

This item consists of the credit and debit balances held with the provincial Treasury offices administered by the Bank.

22. MISCELLANEOUS SERVICES FOR ACCOUNT OF THE GOVERNMENT

Represent a regrouping of a number of miscellaneous accounts with the Treasury.

27. DEPOSITORS (MEMORANDUM ACCOUNTS)

This item consists of securities and other valuables belonging to third parties deposited in accordance with legal provisions either to be administered by the Bank or as collateral; it also includes securities deposited by the credit institutions as part of their compulsory reserves or as collateral for circular cheques or security for advances.

NEDERLANDSCHE BANK

I

ORIGINS AND LEGAL FRAMEWORK

The Netherlands Bank was founded in 1814. It has its Head Office in Amsterdam, an office in Rotterdam, and branches—fifteen in all—in most of the other principal towns of the country. In addition, the Bank has thirty-nine agents, mainly in smaller centres.

The legal status and the activities of the Netherlands Bank are governed by the Bank Act 1948 (*Staatsblad* I 166), as amended by the Acts of January 18, 1952 (*Staatsblad* 35), and July 13, 1955 (*Staatsblad* 335). In addition, the Act of January 11, 1956 (*Staatsblad* 29), contains certain rules concerning the limitation of the aggregate amount of the Bank's notes and drafts outstanding and its liabilities on current account. Provisions about the Bank's activities in regard to the supervision of the credit system are contained in the Act of June 21, 1956 (*Staatsblad* 427).[1]

Legally the Netherlands Bank is a joint-stock company with limited liability of the shareholders. As such it is governed by the provisions which the Netherlands Commercial Code contains for this category of companies in general. By virtue of those provisions a limited liability company has to have statutes. The statutes of the Netherlands Bank, as at present in force, date from March 1949. They were amended in April 1957. The statutes of the Bank consist of the text of the Bank Act 1948 (as amended), together with a number of additional articles dealing chiefly with questions of organization and administration.

The Bank's capital amounts to Fl. 20 million, fully paid up.[2] Since 1948 the capital has been owned entirely by the state. Of the annual profits of the Bank 20 per cent has to be paid into the Bank's general reserve fund until that fund has reached an amount equal to the capital. The surplus is paid to the state.[3]

[1] Before 1948 the legal status and activities of the Netherlands Bank were governed by the Act of December 22, 1863 (*Staatsblad* 148), which in the course of years had been amended many times. In its final form the Act of 1863 was known as the Bank Act 1937. On the coming into force of the Bank Act 1948, the Bank Act 1937 was repealed.

[2] Bank Act 1948, Article 4. [3] *Ibid.*, Article 36.

As a shareholder—in fact the one and only shareholder—the state has but little power. It has no concern with the administration and business of the Bank or with the day-to-day execution of its policy. It has no say in the approval of the Bank's annual balance sheet and profit and loss account as long as these annual statements of account are in conformity with the provisions of the law and the statutes of the Bank. But it appoints—as the one and only shareholder—the members of the Board of Commissaries of the Bank, of which more will be said later. The General Meeting of shareholders is always attended by a government official whom the Minister of Finance designates for the purpose as the representative of the state.

Quite independently of its ownership of the Bank's capital the Netherlands Government has, by virtue of the law, certain powers in regard to the Bank. These powers will be dealt with below.

II

FUNCTIONS AND OBJECTIVES

The objectives of the Bank, as specified in the Bank Act 1948, are threefold.[1]

In the first place, the Bank has to regulate the value of the Netherlands guilder in such manner as is deemed most conducive to the country's prosperity, and therewith to stabilize its value as far as possible. Secondly, it has to provide for the bank-note circulation in the Netherlands and to facilitate money transfers both at home and between the Netherlands and other countries. Thirdly, the Bank is charged with the supervision of the credit system in the Netherlands on the basis of the provisions contained in the Act of June 21, 1956 (*Staatsblad* 427), officially known as the Act on the Supervision of the Credit System.

It is clear that the first of these three objectives gives the Bank the power to act as a monetary authority. As such it possesses a large measure of independence and has a responsibility of its own. It is expected to take the initiative in matters of monetary policy and to devise as well as carry out any measures within its powers which it deems desirable or necessary in order to attain the objective of regulating the value of the Netherlands guilder in the manner indicated by the Bank Act. This, however, does not mean—as will be explained in Section V of this chapter—that the full and final responsibility for the monetary policy pursued by the Netherlands lies with the Netherlands Bank.

[1] Bank Act 1948, Article 9, as amended by the Act of January 18, 1952 (*Staatsblad* 35).

With regard to that part of its appointed task which consists in providing for the bank-note circulation in the Netherlands, the Bank is restricted on the one hand by the fact that it is only allowed to conduct operations of the types enumerated in the Bank Act, and on the other hand by the legal provisions concerning the limitation of the aggregate amount of its notes and drafts outstanding and its current-account liabilities. These points will be dealt with in Section IV below.

The supervision of the Netherlands credit system with which the Bank is charged is twofold. It is exercised partly in the interest of the solvency and liquidity of the registered banks and partly as an instrument to assist the Bank in pursuing its monetary policy. As will be further elaborated in Section IV, the Act on the Supervision of the Credit System authorizes the Netherlands Bank under certain circumstances, and for purposes of monetary policy, to issue general instructions (*algemene voorschriften*) to the banks. Such general instructions can, however, only be given with the consent of the Minister of Finance. Moreover, within three months after the Minister of Finance has given his consent, a bill has to be introduced into the States General in order to have the instructions confirmed by law.

III

STRUCTURE AND ADMINISTRATION

MAIN ORGANS

The main organs of the Netherlands Bank are: the Governing Board, the Board of Commissaries, the Royal Commissioner and the Bank Council. Each of these will be dealt with in turn and a brief description given of their constitution and functions.

THE GOVERNING BOARD

The Governing Board of the Netherlands Bank consists of a President, a Secretary and not less than three or more than five directors. The decision as to the number of directors lies with the joint meeting of the Governing Board and the Board of Commissaries.[1] At present there are three directors. All the members of the Governing Board are full-time executive members.

The President and the Secretary are appointed for a period of seven years by the Crown. At the end of that period they are immediately eligible for reappointment. For each appointment a recommendation list containing two names is to be submitted to the

[1] Bank Act 1948, Article 22.

Crown. The list has to be drawn up at a joint meeting of the Governing Board and the Board of Commissaries. The Crown, however, is not legally bound to appoint either of the persons named in the list; the law allows the Crown to disregard the list altogether.[1] In actual fact, the decisions in regard to the appointment of a President or a Secretary of the Bank are decisions of the Council of Ministers, because the Council's Rules of Procedure provide that a proposal to be made to the Crown for either of these appointments shall be discussed and decided upon at a meeting of the Council.[2]

So far a recommendation list for the appointment of either a President or a Secretary has never been disregarded by the government. The first person on the list has always been appointed. Reappointment of both the President and the Secretary at the end of their terms of office has so far been a regular practice, unless, of course, the person concerned has not wished to be reappointed.

The directors of the Bank are also appointed for a period of seven years by the Crown. Like the President and the Secretary, they are immediately eligible for reappointment at the end of their terms of office. For each appointment a list of three names, drawn up at a joint meeting of the Governing Board and the Board of Commissaries, is submitted to the Crown. The law takes it that in the normal course of events one of the persons on the list will be appointed. But in case none of the candidates is acceptable the law also provides that if no appointment is made within three weeks of the list's being submitted a new list of three names, drawn up at a joint meeting of the Governing Board and the Board of Commissaries, is to be submitted to the Crown. If no appointment from the new list is made within three weeks, the Crown makes provision for the appointment.[3] Proposals in regard to the appointment of a director of the Bank have to be made to the Crown by the Minister of Finance. Decisions on this subject are therefore in actual fact his decisions.

Up to now it has never happened that the appointment of a new director of the Bank has not been made from among the three names on the first list submitted to the Crown. Reappointment of directors on expiration of their terms of office has so far been a regular practice, except where the person concerned has not wished to be reappointed.

The joint meeting of the Governing Board and the Board of Commissaries may appoint substitute directors for such time and subject to such rules and conditions as the meeting may lay down on making the appointment. An appointment of a substitute director for

[1] Bank Act 1948, Article 23, paragraphs 1 and 3.

[2] Rules of Procedure for the Council of Ministers (*Staatsblad* 1956, No. 309), Article 4, paragraph 2 e.

[3] Bank Act 1948, Article 23, paragraphs 2 and 3.

a period longer than six months is subject to the approval of the Crown.[1] In the past a substitute director has occasionally been appointed to take the place of a regular director during his absence on a mission abroad, though so far never for longer than six months.

The salaries of the members of the Governing Board are determined, subject to the approval of the Crown, by the Board of Commissaries. This provision does not apply to substitute directors.[2]

The Governing Board represents the Bank in legal proceedings and otherwise and is charged with the administration of the Bank in the fullest sense of the word. All members of the Bank's staff, including managers of the office in Rotterdam and the branches, are appointed by the Governing Board. The same applies to the agents.

The Governing Board is autonomous in all matters which are not, by virtue of the Bank Act or the statutes of the Bank, specifically assigned for decision to the joint meeting of the Governing Board and the Board of Commissaries. The matters so assigned are, however, mainly matters of internal organization. Besides the drawing-up of the recommendation lists for the appointment of either a President or a Secretary, and of the lists of three names for the appointment of directors, the decision lies with the joint meeting in the following matters:

(1) determination of the number of directors;[3]
(2) appointment of substitute directors;[4]
(3) foundation or discontinuation of branches;[5]
(4) remuneration of the managers of the Rotterdam office and the branches;[6]
(5) convocation of an extraordinary meeting of shareholders;[7]
(6) establishment of rules and regulations in regard to
    division of labour within, and procedure at meetings of, the Governing Board,[8]
    functions of, and procedure at meetings of, the Board of Commissaries,[9]
    business to be conducted and procedure at the joint meetings of the Governing Board and the Board of Commissaries;[10]
(7) investment of the Bank's capital and reserves;[11]
(8) the Bank's Pension Fund.[12]

[1] Bank Act 1948, Article 24. [2] Statutes of the Bank, Article 25 d.
[3] Bank Act 1948, Article 22, paragraph 2. [4] *Ibid.*, Article 24, paragraph 1.
[5] Statutes of the Bank, Article 29 c. [6] *Ibid.*, Article 29 c.
[7] *Ibid.*, Article 36 b, paragraph 2. [8] Bank Act 1948, Article 25, paragraph 2.
[9] *Ibid.*, Article 29. [10] Statutes of the Bank, Article 29 b, paragraph 4.
[11] Bank Act 1948, Article 18, paragraph 2. [12] *Ibid.*, Article 8.

It follows from the above that the Governing Board is autonomous in all decisions on matters of monetary policy. Changes in the rate of discount, for example, are decided upon by the Governing Board alone. The Board is under no obligation—legal or otherwise—to ask anybody's advice on these matters.

THE BOARD OF COMMISSARIES

The Board of Commissaries of the Netherlands Bank consists of twelve members. They are appointed for a period of four years by the shareholders (i.e. by the state as the sole shareholder of the Bank) from lists of three names for each vacancy to be filled. These lists have to be drawn up at a joint meeting of the Board of Commissaries and the Bank Council. Each year three commissaries retire. Those retiring are immediately eligible for reappointment. If a vacancy occurs in the course of a member's term of office, the new member is appointed for the unexpired portion of his predecessor's term.[1]

The appointment of the commissaries by the state means that in fact they are chosen (from among the three names on each of the above-mentioned lists) by the Minister of Finance. Commissaries receive an attendance fee, fixed by the General Meeting of shareholders, for each meeting they attend. Travelling expenses are reimbursed to them.[2]

The Board of Commissaries supervises the management of the Bank and establishes the annual balance sheet and profit and loss account. Subject to the provisions of Article 49 a of the Commercial Code, the balance sheet and profit and loss account so established operate as full discharge for the Governing Board.[3] In the event of a difference of opinion between the Governing Board and the Board of Commissaries about the annual statements of account, the matter has to be referred for final decision to a committee of five experts to be appointed for the purpose.[4] So far this has never occurred.

As already mentioned, the Board of Commissaries determines, subject to the approval of the Crown, the remuneration of the members of the Governing Board[5]; it also appoints four members of the Bank Council.[6] In addition, the Board deals with cases of appeal

[1] Bank Act 1948, Article 27. [2] Statutes of the Bank, Article 29 d.

[3] By virtue of Article 49 a of the Netherlands Commercial Code a member of the governing board of a limited liability company is, even after having obtained full discharge for his administration, liable to be sued for damages on behalf of the creditors of the company if the company goes bankrupt and the state of the company can be proved to be due, wholly or partly, to serious fault or neglect on his part.

[4] Bank Act 1948, Article 28. [5] Statutes of the Bank, Article 25 d.

[6] Bank Act 1948, Article 32, paragraph 1.

from certain decisions of the management of the Bank's Pension Fund.[1]

The Board of Commissaries has the further task, jointly with the Governing Board, of making decisions on certain matters already enumerated. These joint meetings, at which the President reports on the Bank's policy, take place once a month and ensure that there is regular and close contact between these bodies. This in turn assists the Board of Commissaries in carrying out the last (but by no means the least) of its tasks, that of acting as an advisory body in all matters concerning the Bank on which the Governing Board chooses to consult it.

THE ROYAL COMMISSIONER

The Royal Commissioner of the Bank is appointed, without any official recommendation and for an unlimited period, by and receives his instructions from the Crown (in fact the Minister of Finance). His remuneration is paid by the state. The Royal Commissioner is not a member of the Board of Commissaries. He is, however, entitled to attend all meetings of the Board of Commissaries, including the joint meetings of the Governing Board and the Board of Commissaries, and to speak there in an advisory capacity.[2] He is not entitled to attend the meetings of the Governing Board.

The function of the Royal Commissioner consists of supervising, on behalf of the government, the Bank's activities. The Governing Board is legally bound to provide him at his request with all the information which he deems necessary for the proper exercise of his function.[3] By virtue of a conventionally established rule this provision does not apply to information concerning individual transactions concluded by the Bank.

The supervision exercised by the Royal Commissioner is of a formal character. He has to see to it that the Bank observes the provisions of the law and of its statutes. Any irregularities in this regard which come to his knowledge he reports to the Minister of Finance.

The principal task of the Royal Commissioner is to ensure that the Bank's annual balance sheet and profit and loss account are in accordance with the provisions of the law and of the Bank's statutes. If in his opinion they are not, he notifies the Governing Board of his objections in writing. If the matter cannot be settled by joint consultation it is handed over for decision to a group of three arbitrators. One of these arbitrators is chosen by the Minister of Finance and one

[1] Bank Pension Fund Regulations 1954, Article 18.
[2] Bank Act 1948, Article 30. [3] *Ibid.*, Article 30, paragraphs 1 and 3.

by the Governing Board of the Bank. The third is appointed by the President of the Court of Justice in Amsterdam. The decision of the arbitrators is final.[1] Until now the case foreseen in these provisions has never occurred.

THE BANK COUNCIL

The Bank Council of the Netherlands Bank consists of seventeen members, viz. the Royal Commissioner of the Bank, four members appointed by and from the Board of Commissaries and twelve members appointed by the Crown (in fact, the Minister of Finance). The Royal Commissioner is *ex officio* Chairman of the Bank Council.

Each of the four members of the Council appointed by the Board of Commissaries holds office until the end of his term as commissary. If he is reappointed as such, he becomes immediately eligible for reappointment as a member of the Bank Council.

The twelve Crown-appointed members of the Bank Council are selected to represent industry, trade and transport, agriculture, the trade unions, and experts in the field of money and banking. Each of the Crown-appointed members is chosen from a list containing two names. The lists are drawn up as follows: for four of the twelve members by the central associations of employers, for two of them by the central organization of farmers, for three by the central organization of the trade unions, and for the remaining three members by the Netherlands Association of Bankers, the Stock Exchange Committee and the Association for the Study of Economics respectively.

The Crown-appointed members of the Council hold office for four years, three of them retiring each year. Those retiring are immediately eligible for reappointment. If a vacancy occurs in the course of a member's term of office, the new member is appointed for the unexpired portion of his predecessor's term.

The Bank Council has to meet at least six times a year.[2] Members receive an attendance fee, fixed by the General Meeting of shareholders, for each meeting they attend. Travelling expenses are reimbursed to them.[3]

The meetings of the Council are attended by the Governing Board of the Bank, the Treasurer General and one representative each of the Minister for Economic Affairs, the Minister of Agriculture and the Minister for Social Affairs. The President of the Bank reports to

[1] Bank Act 1948, Article 31.

[2] *Ibid.*, Article 32; royal decree of August 6, 1948 (*Staatsblad* I 358), as amended by royal decrees of September 18, 1951 (*Staatsblad* 425), June 14, 1956 (*Staatsblad* 353), and October 21, 1958 (*Staatsblad* 476).

[3] Statutes of the Bank, Article 34 c.

the Council on general economic and financial conditions and on the policies being pursued by the Bank.[1]

The Bank Council is designed as an advisory organ for both the Minister of Finance and the Governing Board of the Bank in matters of policy. The law ensures that the Council is kept informed of the Bank's policy by providing that the President of the Bank is to report to the Council on that subject.[2] The Minister of Finance is legally bound to consult the Bank Council in four cases, viz.:

(1) if he wishes to give directives to the Governing Board for the purpose of co-ordinating the policy of the Bank and the monetary and financial policy of the government;[3]
(2) on the draft of any royal decree designed to authorize the Bank to conduct activities other than those mentioned in the Bank Act;[4]
(3) on the draft of any royal decree designed to lay down or amend regulations as provided for in the Act of January 11, 1956 (*Staatsblad* 29), concerning the limitation of the aggregate amount of the Bank's notes and drafts outstanding and its current-account liabilities;[5]
(4) before giving his consent to the issue of general instructions by the Bank to registered credit institutions for purposes of monetary policy.[6]

On each of these four points more will be said later.

Furthermore, the Minister of Finance may, after consulting the Governing Board, consult the Bank Council on any matters of importance for the guiding principles of the Bank's policy.[7] The Bank Council is also authorized to offer on its own initiative advice to the Minister of Finance on such matters.[8] The Council may discuss, on the initiative of one or more of its members, questions connected with the status and functions of the Bank.[9]

Although the law does not say so in as many words, there is no doubt that the Governing Board of the Bank may consult the Bank Council whenever it wishes to do so.

ORGANIZATIONAL STRUCTURE OF THE HEAD OFFICE

The Head Office of the Netherlands Bank is divided into a number of departments. The principal departments are:

[1] Bank Act 1948, Article 33, paragraphs 1 and 2.
[2] *Ibid.*, Article 33, paragraph 2. [3] *Ibid.*, Article 26, paragraph 1.
[4] *Ibid.*, Article 21. [5] Act of January 11, 1956 (*Staatsblad* 29), Article 3.
[6] Act on the Supervision of the Credit System, Article 10, paragraph 5.
[7] Bank Act 1948, Article 33, paragraph 3.
[8] *Ibid.*, Article 33, paragraph 4. [9] *Ibid.*, Article 33, paragraph 2.

General Secretariat
Research Department
Staff Department
Cashiers' Department
Discount Department
Safe Custody and Loan Department
Foreign Department
Exchange Control Department
Current Accounts and Transfer Department
Book-keeping Department
Department for Internal Supervision
Inspector's Department
Department for Internal Organization
Accountants' Department
Technical Department.

The names of most of these departments speak for themselves. The Department for Internal Supervision supervises on a day-to-day basis all transactions of the Bank from a book-keeping point of view. The Inspector's Department checks the *de facto* presence of all valuables under the Bank's control, at the Head Office as well as at the Rotterdam office, the branches and the agents. By virtue of an arrangement between the Governing Board and the Board of Commissaries the head of the Department for Internal Supervision and the Bank's Inspector, in addition to their other duties, report directly and in detail to the Board of Commissaries at the end of each month.

Since 1962 the Bank has had independent auditors; they report directly to the Board of Commissaries.

The Accountants' Department is mainly concerned with the supervision of the country's credit system, with which the Bank has been charged by law since 1948.

BRANCHES

The position of the Netherlands Bank in the banking system has changed greatly since before the first world war. The extensive network of branches with which the leading commercial banks have gradually covered the country, together with the establishment over the years of numerous agricultural credit banks, has created so many facilities for obtaining credit that the services of the Netherlands Bank are no longer required for that purpose. The Bank has not endeavoured to maintain its former direct relations with the private sector of the economy, since it has felt that it should not compete with the commercial banks. This has applied particularly since 1932,

when—on its own initiative and without as yet being legally bound to do so—the Bank began to exercise a measure of supervision over the activities of the banking system.

One of the results of the Netherlands Bank's becoming a pure bankers' bank was that the Bank's branches lost a great deal of their former importance. They practically never transact any discount business nowadays, and the aggregate amount of the loans that they occasionally grant is hardly of importance. Their main function now is to act as central depôts for bank-notes and other currency in their respective areas, to facilitate money transfers to other parts of the country and to keep the Head Office informed on local conditions. The Rotterdam office and the Hague branch also act as clearing centres for the local banks, as the Head Office does for the principal commercial banks in Amsterdam.

Consequently the administration of the branches of the Netherlands Bank does not give rise to any very great problems. The branches have hardly any local autonomy. All branches have to report their transactions daily to the Head Office.

The offices of the agents are—with four exceptions—strictly speaking not branches at all. The persons who act as agents are as a rule not employees but mandatories of the Bank. The Bank entrusts them with a stock of cash for use in exchanging bank-notes against other bank-notes as requested by the public. The agents are entitled to lend their services for the conducting of discount and loan business with the Bank (which in practice rarely takes place) and for accepting securities in safe custody (which occasionally happens). They are also entitled to sell drafts on the Head Office, the Rotterdam office or the branches.

WEEKLY RETURN AND ANNUAL REPORT

The Netherlands Bank is legally bound to publish once a week, by insertion in the *Nederlandse Staatscourant*, an 'abbreviated balance sheet' in a form to be approved by royal decree.[1] The return shows the Bank's position at the close of business on the first working day of each week and is published on the following working day. An English translation of the Bank's return as at December 31, 1962, together with a note explaining some of the items, will be found in the annex to this chapter.

By virtue of the statutes of the Bank the President has to present to the shareholders at their ordinary general meeting, to be held each year not later than May 1st, a report on the past financial year.[2] It is an established practice that this report is published, although there is no legal obligation to that effect. By tradition the report

[1] Bank Act 1948, Article 35.

[2] Statutes of the Bank, Article 36 b.

contains a detailed analysis of economic, financial and monetary developments during the year under review, the President often availing himself of the opportunity to express his opinion on events or problems of current interest.

IV

POWERS AND ACTIVITIES

NOTE ISSUE

The Netherlands Bank is, and always has been, the sole bank of issue in the Netherlands. Its monopoly, which for many years was only *de facto*, was legalized by the Bank Act 1948.[1] Since 1904 the Bank's notes have constituted unlimited legal tender.[2] They are issued in denominations of Fl. 10, 25, 100 and 1,000. The smallest denomination of notes the Bank is legally allowed to issue is Fl. 5.[3] In actual fact, however, bank-notes in denominations smaller than Fl. 10 have never been issued. The Bank is no longer legally bound to pay its notes in other legal tender on presentation, as it was until 1936. It is only bound to exchange them for other notes, and, of course, to credit accounts in its books with the countervalue of notes delivered at its offices.[4]

The only other notes at present circulating in the Netherlands are the currency notes of Fl. 2·50, issued as legal tender by the government in virtue of the royal decree of February 4, 1943 (*Staatsblad* D 67), as amended by the royal decrees of June 24, 1943 (*Staatsblad* D 68), March 9, 1945 (*Staatsblad* F 34), and May 18, 1945 (*Staatsblad* F 80). In addition, there were until fairly recently Fl. 1 currency notes in circulation (also with the quality of legal tender), issued by the government in virtue of the same royal decrees. These notes were, however, withdrawn from circulation in the years 1956–58 and replaced by silver coins of Fl. 1. In January 1961 a beginning was made with the issue of silver coins of Fl. 2·50 which are intended to replace the currency notes of that denomination. As a result, the aggregate amount of government notes outstanding has considerably diminished during the last few years. At the time of writing it is of the order of magnitude of Fl. 60 million, an amount equal to little more than 1 per cent of the total of bank-notes outstanding. Legally the government is authorized, in virtue of the

[1] Bank Act 1948, Article 10, paragraph 1.
[2] *Ibid.*, Article 10, paragraph 2.
[3] *Ibid.*, Article 12, paragraph 2.
[4] *Ibid.*, Article 11.

decrees just mentioned, to issue currency notes up to a maximum of Fl. 1,200 million.

Besides its notes the Bank is entitled to issue drafts to order on its offices or agents.[1] These drafts, originally (in 1863) conceived as a means of facilitating payments between different parts of the country, have never been very popular. They are seldom issued nowadays. The amount of Bank drafts outstanding rarely exceeds Fl. 2 million.

The Bank Act 1948 provided that rules should be laid down by law under which the Crown should issue regulations limiting the aggregate amount of the Bank's notes, drafts and current-account liabilities that could be outstanding at any one time.[2] One of the objects of this was to assist in maintaining the stability of the Netherlands guilder. Such rules were laid down in an Act of January 11, 1956 (*Staatsblad* 29), which provides for the Crown to issue regulations fixing a minimum proportion in which the Bank must hold a stock of gold and foreign exchange against the above-mentioned liabilities. The Act of January 11, 1956 (*Staatsblad* 29), further provides that the said regulations shall contain certain definitions and a determination of the basis for the valuation in guilders of the Bank's gold and foreign exchange holdings, that any royal decree containing or amending such regulations shall be issued only after the Bank and the Bank Council have been consulted, and that any such decree shall be inserted in the *Staatsblad.*

In pursuance of the Act of January 11, 1956 (*Staatsblad* 29), the royal decree of June 27, 1956 (*Staatsblad* 357), provides that the Bank shall hold, against the aggregate amount of its notes and drafts outstanding and its liabilities on current account, a stock of gold and foreign exchange which, expressed in guilders, represents not less than 50 per cent of their value. For the application of this decree the Bank's gold is to be valued at the price resulting from the parity that has been notified by the Netherlands to the International Monetary Fund for the guilder in relation to gold, less $\frac{1}{2}$ per cent. Foreign exchange is deemed to mean convertible foreign exchange only and is to be valued on the basis of the official buying prices as determined by the Bank in agreement with the Minister of Finance. The Bank's foreign currency liabilities are to be deducted, for the application of this decree, from the amount of convertible foreign exchange on the assets side of the balance sheet.

Owing to the fact that in recent years the Bank's stock of gold and foreign exchange has almost always been considerably in excess of 50 per cent of the aggregate amount of its notes and drafts outstanding and its liabilities on current account, the limitation just outlined has hardly been a factor in determining the Bank's policy.

[1] Bank Act 1948, Article 15, item 1.

[2] *Ibid.*, Article 17.

OPERATIONS

Throughout its existence the Netherlands Bank has on principle been allowed to carry out only those operations which are enumerated in its charter. The types of operation which the Bank is authorized to conduct by virtue of the Bank Act 1948 are the following:

(1) receiving money on current account, executing transfer and payment orders, collecting on behalf of customers, and acting as a clearing centre with or between third parties;
(2) discounting:
  (*a*) bills of exchange and promissory notes for which two or more parties are jointly and severally liable and which run for periods not longer than trade usages entail;
  (*b*) Treasury paper issued by the Netherlands Government;
  (*c*) subject to the discounter's joint liability, bonds repayable within six months;
(3) buying and selling:
  (*a*) bills of exchange accepted by banks or bankers resident in the Netherlands and running for periods not longer than trade usages entail;
  (*b*) Treasury paper issued by the Netherlands Government;
  (*c*) bonds quoted on the Amsterdam Stock Exchange issued, or guaranteed as to interest and principal, by the Netherlands Government;
(4) buying and selling mail and telegraphic transfers, cheques, bills of exchange, other commercial paper and Treasury paper, all payable abroad;
(5) granting advances by way of loan or on current account against the collateral of securities, merchandise, warehouse receipts, coin, bullion and the types of asset mentioned under (2), (3) and (4) above;
(6) dealing in precious metals, causing them to be coined and causing ores and metals to be assayed and refined;
(7) taking securities and other valuables into safe custody.[1]

The list requires little comment. Item (3) authorizes the Bank to conduct operations on the money and capital markets. Item (4) pertains to the Bank's foreign exchange business.

The Bank is further entitled to invest its capital and reserves in accordance with rules laid down by the joint meeting of the Governing Board and the Board of Commissaries[2] and to purchase, with a view to realization, any assets pledged to the Bank by way of security, in cases where such assets are to be sold under a writ of execution.[3]

[1] Bank Act 1948, Article 15.
[2] *Ibid.*, Article 18.
[3] *Ibid.*, Article 16, paragraph 2.

The Bank is forbidden to grant unsecured credits or advances.[1] An exception to this prohibition is made for the advances on current account which the Bank is legally bound to give to the state. The Bank has to grant such advances at the discretion of the Minister of Finance 'for temporary reinforcement of the Treasury', as the law puts it, free of interest and to an aggregate amount not exceeding Fl. 150 million.[2]

The Netherlands Bank is legally bound to act, free of charge, as banker to the government, to the Postal Savings Bank and to such other government institutions, created or to be created by law or by royal decree, as the Minister of Finance may designate. It has to take and hold in safe custody, free of charge all securities and other valuables owned by or pledged to the state or the government institutions mentioned above.[3] As banker to the government the Netherlands Bank is the sole depositary for surplus government funds. In conformity with the Bank's practice of not paying interest on deposits, the government receives no interest on such funds.

The Bank does not manage the public debt. It does, however, although not under any legal obligation in this respect, supervise the printing and manage the issue and withdrawal of the currency notes already mentioned, for account of and on behalf of the state.

The Bank may be authorized by royal decree to conduct, in the general interest, activities other than those mentioned in the Bank Act. The advice of the Bank Council has to be obtained on the draft of any such decree and the decree inserted in the *Staatsblad* and the *Nederlandse Staatscourant*.[4] By virtue of this provision, which was already to be found (although somewhat differently worded) in the older legislation, the Netherlands Bank was authorized by royal decree of May 14, 1930 (*Staatsblad* 181), to participate in the capital and activities of the Bank for International Settlements in Basle, and by royal decree of October 21, 1952 (*Staatsblad* 509), to participate in the capital of the Company for the Financing of National Reconstruction at The Hague.

DE FACTO BUSINESS

The volume of credit operations carried out by the Bank with the private sector of the economy has greatly diminished during the past two or three decades. Owing to the vigorous growth, already mentioned, of the commercial banking system and of the agricultural credit banks, the Netherlands Bank's customers nowadays are mostly banks or private banking firms. The Bank still has a limited

[1] Bank Act 1948, Article 16, paragraph 1.
[2] *Ibid.*, Article 20, as amended by the Act of July 13, 1955 (*Staatsblad* 335).
[3] *Ibid.*, Article 19. [4] *Ibid.*, Article 21.

number of private customers, who occasionally take up an advance on current account, usually against securities; but its direct relations with industry, trade, transport and agriculture no longer amount to much. On the other hand, nearly all the commercial banks and banking firms as well as the central agricultural credit banks regularly hold Treasury bills, Treasury bonds or securities at the Bank, which are pledged to the Bank and against which advances can be taken up at any time as and when required. Such advances are granted by the Bank on a day-to-day basis. They may be repaid at any time, the borrower being charged interest only on the amount taken up and for the number of days the advance has run.

In addition, the Amsterdam bill brokers often make use of the facilities of the Bank. Any tightening of conditions in the Amsterdam money market is sure to make the bill brokers have recourse to the Bank. They do so either by taking up advances against Treasury bills or by rediscounting such bills at the Bank. In times of stress the commercial banks too will rediscount at the Netherlands Bank, preferably Treasury bills but sometimes also commercial paper.

The foreign exchange business of the Netherlands Bank is almost exclusively transacted with the commercial banks. As a rule the Bank holds fairly substantial amounts in foreign exchange, the bulk of which is usually invested on the markets concerned, through the intermediary of the Bank's foreign correspondents, in Treasury paper or bank acceptances, or placed on deposit with such correspondents.

An important part of the Bank's business consists in serving as an intermediary for interbank payments at home. Payment by cheque has never become very popular in the Netherlands. Payments not made in actual cash are as a rule made by giro transfer. Smaller amounts are usually settled by means of the Postal Cheque and Giro Transfer Service. Interbank payments are mostly made through the Netherlands Bank. The daily turnover on the accounts of the leading commercial banks in the books of the Netherlands Bank is for that reason considerable. In connection with these interbank payments, daily clearings between and with the principal commercial banks take place, as already indicated, at the Bank's Head Office, at its Rotterdam office and at its branch at The Hague.

Finally, the Netherlands Bank, in addition to acting as a depositary for the safe custody of securities and other valuables owned by or pledged to the government and certain government institutions, such as the Postal Savings Bank and the Social Insurance Fund, renders the same service to a fair number of companies and private individuals who entrust the Bank with safe custody of their securities. The Bank, if so requested, takes charge of the collecting of interest and dividend coupons for these customers and makes its services available for the purchase and sale of securities on their behalf.

FOREIGN EXCHANGE CONTROL

Foreign exchange control in the Netherlands is provided for by the Foreign Exchange Control Decree 1945 (*Staatsblad* F 222), as amended by the Act of June 22, 1950 (*Staatsblad* K 258).[1] Although during the past few years this control has been greatly relaxed, with the result that foreign exchange business is now almost entirely free, it may be worth while sketching in brief outline how foreign exchange control is organized in the Netherlands and what part the Netherlands Bank takes in that control.

By virtue of the decree just mentioned, the general direction of foreign exchange control is reserved to the government. Five ministers—the Minister of Finance, the Minister for Economic Affairs, the Minister for Foreign Affairs, the Minister of Agriculture and the Minister for Overseas Territories—are between them responsible for the policy to be pursued. They are authorized to delegate their powers under the decree to a committee of six persons. Each of the said five ministers appoints one member of this committee, the President of the Netherlands Bank appointing the sixth member.[2] The Netherlands Bank is charged with the administration of foreign exchange control as agent for, and on behalf of, the state.[3]

In actual fact the Exchange Control Committee only functioned during the first few years after the Foreign Exchange Control Decree 1945 came into force. Subsequently the Netherlands Bank has devised and prepared practically all measures of policy, submitting them directly to the five ministers for their approval.

Both the Bank and the five ministers are authorized to delegate specific parts of the administration of the control to other bodies.[4] By virtue of this provision the Bank delegated to the Central Service of Imports and Exports, a government agency, the power to grant licences for payments to non-residents on account of goods imported, and for acquiring claims on non-residents on account of goods exported.

Regulations for supplementing or giving effect to the provisions contained in the Foreign Exchange Control Decree 1945 are issued by the five ministers. They are, however, authorized to delegate this task, in specific cases or groups of cases to be designated by them, to the Netherlands Bank.[5] In practice a great many regulations of this kind have been issued. In so far as they emanated from the five ministers they were called Foreign Exchange Control Resolutions.

[1] The Foreign Exchange Control Decree 1945 is a royal decree. As an emergency measure, taken at a time when the States General were temporarily in abeyance, it is, however, the equivalent of a law.

[2] Foreign Exchange Control Decree 1945, Article 1, paragraph 1.

[3] *Ibid.*, Article 1, paragraph 2.

[4] *Ibid.*, Article 1, paragraph 3.

[5] *Ibid.*, Article 46.

As far as they were issued by the Bank they were termed Foreign Exchange Control Notices.

The Foreign Exchange Control Decree 1945 also empowers the Netherlands Bank to authorize other banks or bankers to act, under its supervision, as foreign exchange banks. Such authorization is subject to provisions laid down by the Netherlands Bank.[1] In actual fact about seventy foreign exchange banks have been appointed.

Finally, the Netherlands Bank, by virtue of the Foreign Exchange Control Decree 1945, determines, in agreement with the Minister of Finance, rates of exchange for foreign currencies for the application both of the provisions contained in the decree and of the regulations issued to supplement or give effect to those provisions. Such rates of exchange must be published on the Amsterdam and Rotterdam Stock Exchanges.[2]

SUPERVISION OF THE CREDIT SYSTEM

As already mentioned, the Netherlands Bank is charged by the Bank Act 1948 with the supervision of the credit system in the Netherlands.[3] The Bank has to exercise this supervision on the basis of the provisions contained in the Act on the Supervision of the Credit System. This Act, which in its original form dated from January 18, 1952 (*Staatsblad* 35), was amended in 1954 and 1956 and promulgated in its amended version as the Act of June 21, 1956 (*Staatsblad* 427). Its main provisions are the following.

The Act concerns five groups of what are termed credit institutions, viz.:

(1) commercial banks
(2) agricultural credit banks
(3) security credit institutions
(4) general savings banks
(5) central credit institutions.

Each of these five types of credit institution is meticulously defined in the Act. Security credit institutions are credit institutions which act primarily as intermediaries in stock exchange dealings, while also to a substantial extent accepting money on deposit or on current account and granting credits on their own account. There are only two central credit institutions: the two central agricultural credit banks.[4]

The names of all credit institutions (except some very small ones) belonging to any of these five groups have to be inscribed in a

[1] Foreign Exchange Control Decree 1945, Article 2.
[2] *Ibid.*, Article 4.
[3] Bank Act 1948, Article 9, paragraph 3.
[4] Act on the Supervision of the Credit System, Article 1.

register of credit institutions.[1] This register is kept by the Netherlands Bank, but the Bank may delegate the keeping of one or more sections of the register, under its supervision, to some other organization.[2] This has been done in two cases. The keeping of the section for agricultural credit banks has been delegated, as far as the banks of this type are members of one of the two central agricultural credit banks (as the great majority of them are), to the latter banks, each for its own members. The keeping of the section for general savings banks has been delegated to the Netherlands Association of Savings Banks.

The register of credit institutions is published once a year in the *Nederlandse Staatscourant*. It can be consulted by anyone at any time free of charge at the Head Office of the Netherlands Bank, its Rotterdam office or any of its branches.[3]

Under the Act on the Supervision of the Credit System the Netherlands Bank is entitled to obtain or cause to be obtained from any registered credit institution all the information which it thinks necessary for carrying out the task conferred upon it by the Act. Every registered credit institution is required once a year to deliver to the Bank a balance sheet and profit and loss account in a form determined by the Bank, and further to deliver to the Bank such periodical statements regarding its business as the Bank may require.[4]

As already mentioned, the supervision of the Bank is twofold. It is partly a supervision in the interests of the solvency and liquidity of the registered banks, and partly an instrument to assist the Bank in pursuing its monetary policy.[5]

With regard to the first part of the supervision, the Bank may draw up guiding principles (*richtlijnen*) to be adhered to by the registered credit institutions in the conduct of their business in the interests of their solvency and liquidity. The Act enumerates the matters on which guidance may be given. The Bank may draw up and amend such guiding principles only after consultation with the representative organization (as designated by the Minister of Finance) of the group of credit institutions concerned.[6] If a registered credit institution does not comply with such guiding principles, or if the Netherlands Bank detects other signs of a development which in its opinion is or might become dangerous to the solvency or liquidity of a credit institution, the Bank will, if necessary, draw the attention of the institution concerned to this fact and advise it to follow a certain course of conduct. If such advice is not followed, the Bank may proceed to publish the advice, subject to an appeal to the Crown.[7]

[1] Act on the Supervision of the Credit System, Articles 3–6.
[2] *Ibid.*, Article 2. [3] *Ibid.*, Article 7. [4] *Ibid.*, Articles 14–16.
[5] *Ibid.*, Article 9, paragraph 1. [6] *Ibid.*, Article 11. [7] *Ibid.*, Articles 17 and 18

Guiding principles of the kind mentioned in the preceding paragraph have so far only been issued to the general savings banks. The Netherlands Bank has, however, notified the registered commercial banks, the central agricultural credit banks, and those local agricultural credit banks that have not joined either of the central agricultural credit banks, of the general principles which the Bank intends to observe in judging solvency and liquidity.

Advice has been given to individual credit institutions on various occasions. Publication of advice given but not followed has so far not taken place.

Upon the advice of the Bank the supervision of specific groups of credit institutions, as far as it relates to their solvency and liquidity, may be delegated by royal decree wholly or in part to other organizations, subject, however, to the proviso that such organizations, in carrying out their task, have to follow the Bank's instructions.[1] In this way the routine part of supervising the solvency and liquidity of the agricultural credit banks that are members of a central agricultural credit bank was delegated to the central organization to which they belong by royal decree of October 28, 1953 (*Staatsblad* 486). The routine part of supervising the solvency and liquidity of the general savings banks was delegated to the Netherlands Association of Savings Banks by royal decree of August 30, 1954 (*Staatsblad* 390).

Finally, except with the approval or acquiescence of the Netherlands Bank, it is illegal for registered credit institutions to

(1) reduce their issued or paid-up capital;
(2) take up a permanent participation in, or take over entirely, any other credit institution whatever;
(3) merge with other enterprises or institutions;
(4) carry out a financial reorganization.

If the Netherlands Bank refuses to allow a registered credit institution to do any of these things, the latter may appeal to the Crown.[2]

So far as supervision in the interests of monetary policy is concerned, the Netherlands Bank, if it detects in the field of credit signs of a development which in its opinion endangers or might endanger the carrying-out of its task of regulating the value of the Netherlands guilder in the manner indicated in the Bank Act 1948, begins consultations with the representative organization of the registered credit institutions concerned as to what should be done. If such consultations lead to agreement with the representative organization, but individual credit institutions do not co-operate to a degree considered sufficient by the Bank, the Bank can issue

[1] Act on the Supervision of the Credit System, Article 9. [2] *Ibid.*, Article 13.

instructions (*voorschriften*) to such individual credit institutions regarding the conduct of their business.

If no agreement is reached with the representative organization, the Bank is entitled to issue general instructions (*algemene voorschriften*) to the group of credit institutions concerned. Such general instructions may contain minimum liquidity requirements, a ceiling for loans or investments and prohibitions or restrictions in regard to certain types or forms of credits. The general instructions can only be issued by the Bank for a period of up to one year; and they can only be issued, amended or prolonged with the consent of the Minister of Finance, after consultation with the Minister for Economic Affairs. Before giving his consent, the Minister of Finance has to consult the Bank Council and to give the representative organization concerned the opportunity to express its views. General instructions of this kind must be published in the *Nederlandse Staatscourant* together with the decision of the Minister of Finance containing his consent. Moreover, within three months after the Minister has given his consent, a bill has to be introduced into the States General for the purpose of legally confirming the general instructions, or their amendment or prolongation. If such a bill is withdrawn, or rejected by one of the two Chambers of the States General, the general instructions, or their amendment or prolongation, are cancelled immediately.[1]

So far, no general instructions of this kind have been given.

Two more provisions of the Act on the Supervision of the Credit System should perhaps be mentioned in this context. The Bank has to publish periodically in the *Nederlandse Staatscourant* a statement of the principal data contained in the annual statements of account and in the periodical statements which it receives from the registered credit institutions, without, however, disclosing figures relating to individual credit institutions except with their written consent.[2] And the Bank has to submit each year to the Minister of Finance a report on the carrying-out of the Act, for publication by the Minister.[3]

POWER TO REGULATE NEW CAPITAL ISSUES

Under an arrangement dating from 1946, which since 1954 has taken the form of a gentleman's agreement with the Netherlands Association of Bankers and the Netherlands Organization of Stockbrokers, the members of both these organizations have undertaken to consult the Netherlands Bank before proceeding to public issues of Dutch shares, bonds or similar securities in amounts of Fl. 10 million or more at a time. The Bank may in these cases ask that an issue be

[1] Act on the Supervision of the Credit System, Article 10.
[2] *Ibid.*, Article 24.
[3] *Ibid.*, Article 25.

deferred to a later date in order to give priority to issues which are considered to be of greater economic importance.

Under the Foreign Exchange Control Decree 1945 foreign capital issues and introductions, public as well as private, and the granting of loans to non-residents require a licence from the Netherlands Bank. In practice no licences have so far been granted for the public issue of foreign shares. Introduction of foreign shares has been allowed on several occasions. Licences for the public issue of foreign bonds and for the granting of loans to non-residents have also been given in a considerable number of cases.

RELATIONS WITH INTERNATIONAL INSTITUTIONS

The Netherlands Bank is a shareholder of the Bank for International Settlements.

The Bank acts as an official channel of communication between the Netherlands Government and the International Monetary Fund.

For the implementation of the European Monetary Agreement and in connection with the operations of the European Fund the Bank acts as agent on behalf of the Netherlands Government.

V

MONETARY POLICY

INSTRUMENTS OF CREDIT CONTROL

The instruments of credit control which the Netherlands Bank has so far employed in order to fulfil its task of regulating the value of the Netherlands guilder in the manner indicated by the Bank Act 1948[1] are the following:

(1) discount policy;
(2) intervention on the money market;
(3) application of a cash-reserve ratio system;
(4) making access to the Bank's resources dependent on the fulfilment of special conditions;
(5) application of qualitative and quantitative restrictions;
(6) moral suasion.

On these matters a few comments are called for.

DISCOUNT POLICY

One of the very first measures taken by the Bank, if it wishes to restrict credit expansion, usually consists of raising its discount rate

[1] Bank Act 1948, Article 9, paragraph 1.

for bills. This rate, considered by common consent as the Bank's representative rate of interest, is in fact one of four different rates, the other three being the discount rate for promissory notes, the rate of interest for loans and advances on current account to private customers, and the rate of interest for loans and advances on current account to others. When the discount rate for bills is raised or lowered, the other rates are nearly always changed accordingly. Both the discount rate for promissory notes and the rate of interest for loans and advances to 'others' are usually ½ per cent higher than the discount rate for bills. The rate of interest for loans and advances to private customers is as a rule 1½ per cent above the discount rate for bills. The banks, if they have to borrow at the Netherlands Bank, often take up advances on current account, because this type of accommodation enables them to borrow for very short periods.

Under certain circumstances the Bank may charge a 'penalty rate', i.e. a rate 1 per cent or more in excess of its scheduled rates. So far such a rate has never in fact been applied; but in September 1957 the Bank gave notice to the banking community that it might feel bound to charge such a 'penalty rate' to banks which did not observe certain specified limits in their lendings to the private sector. This notice was withdrawn in April 1958.

INTERVENTION ON THE MONEY MARKET

In the Netherlands the private sector does not borrow much at the central bank. The credit needed in that sector is provided by what are termed in the Act on the Supervision of the Credit System the credit institutions, particularly by the commercial banks and the agricultural credit banks. Moreover, the credit institutions themselves rarely fall back on the Netherlands Bank. They have large-scale recourse to the Bank only in times of serious deficit in the balance of payments. In times of external surplus hardly anybody borrows money from the Bank. The excess liquidity in the hands of the banking system may at such times easily tend to drive money-market rates down to almost zero, there being for all practical purposes no internal borrowers for such excess funds unless the Treasury or the Netherlands Bank intervenes. At the same time the commercial banks may not have adequate opportunities for placing surplus funds on foreign markets. In general they do not like holding uncovered positions in foreign exchange, and the possibilities of covering the exchange risk by means of forward transactions depend on market conditions.

The negotiable instruments traded in on the Amsterdam money market are mainly Treasury bills and Treasury notes. Treasury bills run from three to twenty-four months, Treasury notes from two to

five years. The aggregate amount of Treasury paper outstanding, apart from the Treasury certificates to be mentioned below, is about Fl. 3,000 million, of which somewhat more than half is in the hands of the banking system. Tenders for Treasury paper are held from time to time by the Agent of the Treasury. They are open to everybody. Allocations are made at one price only. Dealings in Treasury paper are carried out through the optional intermediary of bill brokers, who hold a comparatively small portfolio for their own account, which they finance by taking up money at call. The bill brokers have access to the Netherlands Bank. The larger houses among them even have a special facility for discounting a limited part of their portfolio at the old rate on the day that a rise in the Bank's discount rate becomes effective. In times of stress the bill brokers are usually the first to fall back upon the Bank.

It stands to reason that under these circumstances a rise in the Bank's discount rate cannot always be expected to be effective. If trade or industry is strongly influenced by speculative motives, or if the government is faced with financial difficulties, increases in the discount rate may easily prove insufficient to prevent undue credit expansion. For that reason the Bank is, as already mentioned,[1] authorized by the Bank Act 1948 to buy and sell bills of exchange accepted by banks or bankers resident in the Netherlands, Treasury bills and notes of the Netherlands Government, and bonds quoted on the Amsterdam Stock Exchange and payable, or guaranteed as to interest and principal, by the Netherlands Government.[2] This, of course, means that the Bank is entitled to conduct what are usually termed open-market operations on the money market as well as on the stock exchange. So far the Bank has never conducted operations on the stock exchange, but it does operate on the money market as and when circumstances make it desirable to do so.

If the Bank wishes to restrict credit expansion, its intervention on the money market may be directed towards supporting the effectiveness of an increase in the discount rate by draining the market of excess liquidity. On the other hand, the Bank may also, with the object of stabilizing money-market conditions, intervene to counterbalance a shortage of liquidity.

Until 1952 the Bank could not intervene effectively on the money market. It had no opportunity of selling Treasury paper out of its portfolio to the market, because the Treasury was in the habit of selling Treasury paper over the counter at fixed rates through its Agent, even when its credit balance at the Bank was amply sufficient for its requirements. As a result of the experience gained during the Korean crisis, when the vast increase in the volume of loans granted by the banks to the private sector, and the concomitant reduction in

[1] See page 245 above.

[2] Bank Act 1948, Article 15, item 4.

the amount of Treasury paper held by the banks, necessitated restrictive action by the Netherlands Bank, this state of affairs was changed. The Bank and the Treasury agreed that the latter would in principle refrain from enlarging the amount of Treasury paper directly placed in the market, and that henceforth the Bank would sell Treasury paper out of its portfolio if the market were found to be over-liquid.

APPLICATION OF A CASH-RESERVE RATIO SYSTEM

During 1952 and 1953 the country's gold and exchange reserves increased enormously and there was a concomitant rise in money-market liquidity. Following on these developments, in February 1954 the Treasury, at the instigation of the Netherlands Bank, made an offer to the banks to convert an amount of Fl. 1,200 million of short-term Treasury paper (being the equivalent of about half of their aggregate holdings of Treasury paper) into Treasury certificates having eight, ten and twelve years to run at interest rates of from $2\frac{5}{8}$ to $2\frac{7}{8}$ per cent. At that time the market rate for three-month Treasury bills was about $\frac{3}{8}$ per cent and that for twelve-month Treasury paper about $\frac{5}{8}$ per cent. This offer was made only to such banks as declared themselves prepared to take part in a gentleman's agreement concluded at the same time with the Netherlands Bank and to commit themselves not to sell the Treasury certificates which they would thus acquire to parties outside the agreement. Under the said gentleman's agreement the participating banks undertook to hold with the Netherlands Bank minimum cash balances proportionate to their deposits, the magnitude of such balances to be determined by the Bank between the limits of zero and 15 per cent. The first Fl. 10 million of deposits at each bank was to be exempted, while for the next Fl. 50 million a reserve of only half of the percentage in force was to be held. The Bank for its part undertook to consider, in fixing the reserve ratio, the development of the gold and foreign exchange position together with its causes. This meant, for example, that a loss in foreign exchange reserves accompanied by a loss of deposits might, but a loss in reserves accompanied by an expansion of credit would certainly not, justify a reduction of the reserve ratio. The Bank further undertook not to increase the reserve ratio beyond 10 per cent without first having sold a considerable part of its portfolio of Treasury paper.

The above-mentioned total of Fl. 1,200 million included an amount of Fl. 398·4 million in Treasury certificates having eight years to run. In view of the fact that these Treasury certificates matured on March 1, 1962, arrangements were made for replacing them as from that date by Treasury certificates having ten years to

run at a rate of interest of 3¾ per cent. The banks that are parties to the gentleman's agreement on cash reserves undertook to buy these new Treasury certificates. Like the certificates which they have replaced, the new certificates are not to be sold to parties outside the agreement.

It should be clearly understood that the cash-reserve system just outlined has to be applied in the Netherlands under conditions fundamentally different from those prevailing in some other countries. In the Netherlands, owing to the great importance for the national economy of foreign trade, any undue credit expansion, or at any rate any credit expansion that exceeds developments in neighbouring countries, will soon lead to a deficit in the balance of payments because, marginally, at least one-third of the national expenditure goes outside the country. Consequently, any credit expansion tends strongly to affect the liquidity of the banks, as their deposits are apt to rise far less than their loans. Nevertheless the cash-reserve system renders useful service. But, in comparing its application in the Netherlands with that in other countries, the differences in circumstances should always be kept in mind. Otherwise it becomes incomprehensible that in the Netherlands the reserve ratio has been increased in times of recession and lowered in times of credit expansion.

MAKING ACCESS TO THE BANK'S RESOURCES DEPENDENT ON THE FULFILMENT OF SPECIAL CONDITIONS

This is another device which the Netherlands Bank has applied in order to prevent undesirable expansion of credit. To strengthen its position as a monetary authority the Bank has made it clear that it considers access to its resources as a privilege and not as an established right, even though the prospective borrower may be able to offer perfect security. The Bank, in other words, has reserved the right to refuse credit to prospective borrowers whose course of conduct might in the Bank's opinion, in connection with the security offered or otherwise, hamper it in carrying out its task of regulating the value of the Netherlands guilder in the way indicated in the Bank Act. The Bank could take this attitude the more easily because, as indicated above, the structure of the Dutch money market is such as to leave, between the Bank and the commercial banks, only a thin cushion of Treasury paper held by a comparatively small group of middlemen—the bill brokers—to whom the Bank could not reasonably refuse assistance in case of need. In a period of real stress the commercial banks themselves will always have to fall back on the Bank.

In actual fact the Bank, well aware that part of its function also consists in acting as lender of last resort, has so far never entirely refused to grant credit to prospective borrowers who are fundamentally sound. But it has in some cases made access to its resources dependent on conditions to be fulfilled in regard to the type of security offered or to the course of conduct of the borrowers. In 1957, in view of the excessive short-term borrowing by municipalities and other local authorities which was taking place at that time, it decided until further notice to rediscount promissory notes of local authorities, or to accept such notes as collateral for loans, to a considerably smaller extent than had previously been customary. This was achieved by making the amount to which such notes would be accepted dependent upon the degree to which the authorities concerned kept their floating debt within limits. About the same time the Bank decided to accommodate savings banks only on condition that they refrained from making new investments as long as they were indebted to the Bank.

A more important example of the Bank's making its willingness to grant credit dependent upon the course of conduct of the borrower is to be found in the general understanding between the Bank and the Treasury under which the Bank is in principle not expected to finance ordinary budget expenditure beyond the limit of the Fl. 150 million which it is legally bound to lend to the Treasury free of interest.[1]

APPLICATION OF QUALITATIVE AND QUANTITATIVE RESTRICTIONS

This is a method of credit control closely akin to the one just described. During the reconstruction period immediately following the Second World War the Bank applied rather severe qualitative restrictions by virtue of the executive decrees issued to implement the monetary reform of 1945–46. With the return of more normal conditions this type of control became rather difficult to apply. As from January 1, 1951, it was, therefore, replaced by quantitative restrictions. New loans were only allowed on condition either that the liquid holdings of the lending bank did not drop below a certain level or that the total amount of its loans outstanding did not exceed a certain ceiling, unless recourse was had to the Bank for the excess amount. Thus the restriction implied in these measures was not absolute. It mainly served to make the Bank's discount rate effective and to prevent the banks from continuing to expand credit to the private sector, while at the same time reducing their holdings of Treasury paper. This measure was discontinued as from April 1, 1952.

[1] Bank Act 1948, Article 20. See page 246 above.

As already mentioned, the Act on the Supervision of the Credit System empowers the Bank under certain circumstances, in the interests of monetary policy, to give general instructions (*algemene voorschriften*) to the registered credit institutions concerning the conduct of their business. Instructions of this kind can only be given with the consent of the Minister of Finance and have to be confirmed by law in order to remain in force.[1] So far the power given to the Bank in this respect by the Act on the Supervision of the Credit System has never been used. Quantitative credit restrictions in the sense of an absolute ceiling have never been applied. Without making use of this power the Bank has, however, caused certain rules to be observed with regard to two specific types of credit. This brings us to the last of the instruments of credit control mentioned at the beginning of this section.

MORAL SUASION

As will be clear from what was said in Section IV, the Act on the Supervision of the Credit System definitely recognizes moral suasion as an instrument of monetary policy at the disposal of the Netherlands Bank. If the Bank detects signs of a development which in its opinion endangers or might endanger monetary stability, it begins consultations with the representative organizations of the groups of credit institutions concerned. Only if such consultations do not lead to agreement is recourse had to the issue of formal instructions.

In fact, consultations as contemplated in these legal provisions have, since the beginning of 1955, repeatedly been held by the Bank with the representative organizations of the commercial banks and the agricultural credit banks. In this way, for example, the Bank informed all commercial banks early in September 1957 that it deemed it necessary, in view of the crisis which had just occurred on the foreign exchange market, that the banks should not increase, except for a very short period, the overall total of their loans to the private sector of the economy. On this occasion the Bank urgently appealed to the banks for their co-operation with a view to preventing such an increase in the immediate future. At the same time it announced that it reserved the right to charge—after warning—a 'penalty rate' as mentioned above[2] to banks which in its view were not observing sufficient moderation. There is some evidence that the decline in the volume of credit which occurred in the following months may at least partially be ascribed to this measure.

More recently, consultations with the representative organizations of the commercial banks and the agricultural credit banks have led to

[1] Act on the Supervision of the Credit System, Article 10. See page 252 above.
[2] See page 254 above.

the introduction of a more refined system of quantitative credit restriction. An arrangement was made designed to prevent the total volume of credit granted by the commercial banks and the agricultural credit banks between them from expanding by more than 15 per cent in the year 1961. The arrangement did not apply to loans having on an average two years or more to run.

An individual credit institution was considered to have complied with this 15 per cent rule as long as the average total of its credits outstanding, calculated on the basis of the last three months' ultimo figures, did not exceed the average total for the three corresponding months of the previous year by more than 15 per cent, or as long as the average first mentioned, in comparison with the average for the last quarter of 1960, did not show an increase of more than 1 per cent for each month, augmented by one additional 3 per cent. As soon as the aggregate of the credits granted by the representative commercial banks and the agricultural credit banks between them was in excess of both the limits just described, the Netherlands Bank was to invite each individual credit institution that had failed to keep the volume of its credits outstanding within either one or the other of the two limits to hold with the Bank, in addition to its ordinary cash reserves, an interest-free deposit proportional to the amount by which the volume of its credits outstanding had surpassed the limit. If the individual credit institution concerned acted upon this invitation, it would be considered to have kept its credits outstanding within the 15 per cent limit. There was a hardship clause for small credit institutions and for exceptional cases. The arrangement was applied for the first time to the three-month period ending August 31, 1961.

Until the end of 1961 the aggregate of the credits granted by the representative commercial banks and the agricultural credit banks between them remained below one of the limits agreed upon. Consequently no interest-free deposits were called for from any individual credit institution. In December 1961 new consultations were opened with the representative organizations; as a result, and in view of the continuing tension in the credit situation, the expansion limit of 1 per cent per month was reduced to ½ per cent for each of the first four months of 1962, the other provisions of the arrangement being adjusted accordingly. When it was found that at the end of January 1962 these reduced limits had been surpassed by the representative commercial banks and the agricultural credit banks between them, the individual banks which had surpassed their limits were invited to hold interest-free deposits with the Netherlands Bank as outlined above.

In May 1962 the arrangement was once more renewed for a period of four months, the figure of ½ per cent per month remaining in

force. Another renewal for a period of four months was agreed upon in September 1962; the figure of ½ per cent per month was maintained for September and October but increased to 1 per cent for November and December 1962. In October 1962 it became clear that credit expansion had been checked sufficiently. The aggregate of the credits granted by the representative commercial banks and the agricultural credit banks between them had by the end of August dropped below the established limits. As it subsequently remained below those limits, the arrangement was suspended in January 1963.

Other examples of moral suasion are two notices of the Netherlands Bank on special subjects. One of them, dating from December 1955, was addressed only to a limited number of banks, namely those that had been taking a comparatively important part in financing hire-purchase transactions. These banks were requested to reduce loans for this purpose to a volume equal to the average of the amounts outstanding on December 31, 1953, and June 30, 1955.

In the other notice, dating from September 1957, the Bank informed the credit institutions concerned that it considered an increase of loans to local authorities undesirable and that it would like to see the volume of such loans outstanding reduced to the level at which it had stood some time before.

In both these cases the steps taken by the Bank had a satisfactory effect. The notice of December 1955 was withdrawn in November 1958, while that of September 1957 was suspended in January 1959.

POWERS OF THE GOVERNMENT IN REGARD TO MONETARY POLICY

In principle the Netherlands Bank is free to conduct its monetary policy in the way it wishes and to decide how and when it will use the instruments of credit control at its disposal. Continually watching the course of events in the economic, financial and monetary sectors; detecting undesirable developments; planning how to meet such developments; holding consultations with representative organizations in the banking system; carrying out its decisions in the field of credit control; supervising the reaction of the banks and the effect on the money market of the measures taken—all these things are part of the Bank's appointed task. The Bank in this respect has the responsibility of an independent body.

Yet, as has already been indicated earlier in this chapter,[1] this does not mean that the full and final responsibility for monetary policy lies with the Netherlands Bank. As has repeatedly been mentioned,

[1] See page 233 above.

the giving of general instructions, in the interests of monetary policy, to registered credit institutions regarding the conduct of their business, as provided for in the Act on the Supervision of the Credit System, is a matter in which the Bank is not free. Such general instructions require the consent of the Minister of Finance and have to be confirmed by law in order to remain in force.

Moreover, that is not all. In regard to the general line of the monetary policy to be followed by the Bank, the Bank Act 1948 explicitly provides that the Minister of Finance, whenever he deems it necessary to do so in order to co-ordinate the monetary and financial policy of the government and the policy of the Bank, shall, after having consulted the Bank Council, issue to the Governing Board of the Bank the directives (*aanwijzingen*) required for attaining that purpose.[1] It should be noted, however, that the power thus given to the Minister of Finance is subject to a restriction. If the Governing Board of the Bank objects to the directives issued by the Minister, the Board is entitled to appeal—within three days—to the Crown. The Crown then decides whether the directives are to be followed. But if the Governing Board does not appeal to the Crown within three days, or if the Crown, after an appeal has been made, decides that the directives have to be complied with, the Governing Board must act accordingly.[2] The Bank Act provides that any member of the Governing Board who refuses or deliberately neglects to comply with directives of this kind concerning which the Board has not appealed to the Crown within three days, or in regard to which, if the Board has so appealed, the Crown has decided that they are to be complied with, can be relieved by the Crown of his duties after the Council of State has been consulted.[3]

The right of appeal thus given to the Governing Board of the Bank is not without significance. It means, in the first place, that the Board has it in its power to lay the responsibility for the decision ultimately to be taken upon the government as a whole. For, if the Governing Board appeals, the matter has to be placed before the Council of Ministers, because the Rules of Procedure for the Council of Ministers provide that the draft of any royal decree containing the decision of the Crown in regard to an appeal of the Governing Board of the Netherlands Bank against directives given to it by the Minister of Finance in virtue of the Bank Act 1948 shall be discussed and decided upon in the Council of Ministers.[4]

Secondly, the Bank Act provides that, if the Crown decides that the directives of the Minister of Finance have to be complied with,

[1] Bank Act 1948, Article 26, paragraph 1. [2] *Ibid.*, Article 26, paragraph 2.
[3] *Ibid.*, Article 23, paragraph 5.
[4] Rules of Procedure for the Council of Ministers (*Staatsblad* 1956, No. 309), Article 4, paragraph 2 f.

the objections made by the Governing Board of the Bank, together with the decision of the Crown and a statement of the Crown's motives, shall be published in the *Nederlandse Staatscourant* unless reasons of state forbid.[1] The conflict, therefore, cannot be kept secret; it must be made public. This provision is meant to act as a safeguard against precipitate decisions.

Finally, the fact that the Governing Board of the Bank has been accorded a right of appeal to the Crown against the decision of the Minister of Finance accentuates the large degree of independence enjoyed by the Bank *vis-à-vis* the Minister. It shows that in matters of monetary policy the Board is not subordinate to the Minister but his equal.

During the exchange of views between the government and the Second Chamber of the States General on the subject of the bill which became the Bank Act 1948 the then Minister of Finance, Dr P. Lieftinck, stated that, in his opinion, application of the article appertaining to the directives in question should be considered as an *ultimum remedium*.[2] While Dr Lieftinck was in office the article was never applied. So far his successors have not applied it either.

[1] Bank Act 1948, Article 26, paragraph 4.

[2] Annexes to the Record of Proceedings of the Second Chamber of the States General, 1947–48, No. 488, 8, page 22.

ANNEX

NEDERLANDSCHE

WEEKLY

as at December 31,

Drawn up in pursuance of Article 35 of the Bank Act December 29, 1958

Assets	In thousands of florins
1. Gold	5,697,557
2. Claims and negotiable instruments in gold or in foreign currencies	585,716
3. Foreign means of payment	160
4. Claims on non-residents in guilders	6,926
5. Bills, promissory notes, Treasury paper and bonds discounted	—*
6. Bills, Treasury paper and bonds purchased by the Bank (Bank Act 1948, Article 15, item 4)	597,492
7. Advances on current account (including loans)	72,307
8. Advances to the state (Bank Act 1948, Article 20)	—
9. Netherlands coin	12,756
10. Investment of capital and reserves	183,018
11. Premises and office equipment	1,000
12. Sundry accounts	10,248
Total	7,167,180

* Including in respect of Treasury paper discounted by the Bank directly for the state . . . . . Fl.—

Aggregate amount of Netherlands Treasury paper purchased on behalf of foreign central banks and similar institutions by way of investment of balances in guilders owned by them . . . . . Fl.—

Percentage of gold and foreign exchange holdings as calculated in accordance with Article 2 of the royal decree of June 27, 1956 (*Staatsblad* 357) . . . 90·71

BANK

RETURN

1962

1948 and in accordance with Royal Decree No. 8 of
(*Staatscourant* 1959, 2)

Liabilities		In thousands of florins
13. Notes in circulation		5,757,958
14. Bank drafts		119
15. Residents' balances on current account in guilders:		
Netherlands Treasury	620,358	
Banks in the Netherlands	282,518	
Other residents	133,360	
		1,036,236
16. Non-residents' balances on current account in guilders:		
Foreign central banks and similar institutions	106,091	
Other non-residents	6,159	
		112,250
17. Balances in foreign currencies		18,241
18. Capital		20,000
19. Reserves		168,086
20. Sundry accounts		54,290
Total		7,167,180

Currency notes (issued by the Bank on behalf of the state) in circulation . . . . . Fl. 62,710,871·00

EXPLANATORY NOTE ON THE WEEKLY RETURN

ASSETS

2. CLAIMS AND NEGOTIABLE INSTRUMENTS IN GOLD OR IN FOREIGN CURRENCIES

This item represents the total of the Bank's balances on current account and deposits with foreign correspondents, together with its holdings of Treasury paper, bankers' acceptances, etc., in foreign currencies.

3. FOREIGN MEANS OF PAYMENT

This item gives the Bank's holdings of foreign bank-notes and currency notes, together with foreign coins, except gold coins. Foreign gold coins are accounted for under the heading 'Gold'.

6. BILLS, TREASURY PAPER AND BONDS PURCHASED BY THE BANK

This item represents the total of the assets acquired by the Bank through open-market operations.

8. ADVANCES TO THE STATE

These are the advances which the Bank is legally bound to extend to the state to an aggregate amount not exceeding Fl. 150 million. They do not bear interest.

12. SUNDRY ACCOUNTS

This item includes the shares in the Bank for International Settlements owned by the Netherlands Bank, the accounts of the Bank with the Postal Cheque and Transfer Service, and the current expenditure of the Bank.

LIABILITIES

16. NON-RESIDENTS' BALANCES ON CURRENT ACCOUNT IN GUILDERS

Foreign Central Banks and Similar Institutions

'Similar institutions' include the Bank for International Settlements, the International Monetary Fund and the International Bank for Reconstruction and Development.

20. SUNDRY ACCOUNTS

This item includes the gross profits made by the Bank.

FOOTNOTES

The footnotes are not a part of the official form of the weekly return as approved by Royal Decree No. 8 of December 29, 1958. They contain additional information given by the Bank at its own discretion.

If in the footnote beginning with the words 'Aggregate amount' an amount is mentioned, this does not represent a liability of the Netherlands Bank. The item is, however, of importance for calculating the exchange position of the Netherlands.

The amount of currency notes outstanding includes a certain number of 1-guilder notes which, although officially withdrawn and called for exchange into valid money, have not so far been handed in.

SCHWEIZERISCHE NATIONALBANK

I

ORIGINS AND LEGAL FRAMEWORK

The Swiss National Bank was created by the Federal Law of October 6, 1905, to be the country's central bank. The Bank began its activities on June 20, 1907; at that time there were in Switzerland thirty-six banks of issue, whose entire note circulations were taken over by the Swiss National Bank in the course of the next three years.

The basic provisions at present in force regarding the central bank and the note issue are contained in Article 39 of the Federal Constitution (this Article was amended in 1951) and in the Federal Law concerning the Swiss National Bank (National Bank Law) of December 23, 1953. Further basic legal provisions are mentioned where appropriate in the following pages.

The Swiss National Bank has two seats, Berne and Zurich. Berne is the legal and administrative seat, while Zurich is the seat of the Bank's Directorate. It is laid down by law that the General Meeting of shareholders and, as a rule, the meetings of the Bank Council and the Bank Committee must be held in Berne.[1] Apart from these two head offices the Swiss National Bank has branches in eight towns (Aarau, Basle, St Gall, Geneva, Lausanne, Lucerne, Lugano and Neuchâtel). These conduct the Bank's business in their districts. The Bank has sub-branches of its own in three centres, and in twelve localities cantonal banks conduct sub-branches for it. In 542 other localities the Swiss National Bank had at the end of 1962 450 correspondent banking institutions acting as its local representatives for payment purposes.

The Swiss National Bank is a joint-stock company. In its external form it is an independent legal personality under civil law.[2] Its transactions are therefore mainly conducted through civil-law contracts. In its internal structure, however, the Bank largely has the character of an institution incorporated under public law. Its organization is governed not by articles of association, as in the case of an ordinary joint-stock company, but by the law itself, which also specifies what transactions the Bank is permitted to perform.[3] The law further gives the Swiss Confederation (hereinafter called the

[1] National Bank Law, Article 3.
[2] *Ibid.*, Article 1, paragraph 2.
[3] *Ibid.*, Articles 14–16.

Confederation), by conferring on it a number of important elective and permissive functions, wide powers of supervision over the Bank's activities and a decisive influence on the composition of the Bank authorities and the Bank's management[1] (see pages 271–74).

The Bank's share capital has remained unchanged at 50 million francs since its formation and is half paid-up.[2] Only Swiss citizens and Swiss companies incorporated under public law, together with corporate bodies and trading companies whose head offices are in Switzerland, may be entered in the register of shareholders.[3] Transfers can be made only with the permission of the Bank Committee.[4] The Confederation does not own any part of the Bank's capital. The majority of the shares have been held since the Bank's formation by the cantons and by cantonal banks. At the end of 1962 cantons, cantonal banks and other public-law corporations and institutions together held 58 per cent, and 6,053 private shareholders 42 per cent, of the Bank's capital; 4,811 private shareholders had from one to five shares each. A private shareholder may not, however, cast more than one hundred votes at the General Meeting in respect of his own shares and those which he is representing.

Out of the Bank's net profits as shown in the Profit and Loss Account an amount which may not exceed 2 per cent of the capital is first of all allocated to the Reserve Fund. Then a dividend of up to 6 per cent of the paid-up capital is distributed. Out of the remainder, the cantons receive an indemnity of 80 centimes per head of their populations; if the net profits do not suffice for this, the deficiency is to be made good during the next five years if the Bank's financial results permit. Out of any surplus still remaining, one-third accrues to the Confederation and two-thirds to the cantons.[5]

The Swiss National Bank may not be subjected to any taxation in the cantons.[6] The tax exemption applies to all cantonal and communal taxes and also to indirect taxes, though in the latter case the tax exemption is enjoyed only by the Bank itself, but not by the customer who deals with it. As to Federal taxation, the Swiss National Bank, like other banks, has to pay the Federal stamp duty on bills, securities and coupons; it is also subjected by the Confederation to all direct Federal taxes, but is allowed a deduction corresponding in amount to the percentage share of the Bank's capital held by the cantons and cantonal banks.

II

FUNCTIONS AND OBJECTIVES

The functions of the Swiss National Bank are defined in the Federal Constitution and the National Bank Law. Article 39 of the Federal

[1] National Bank Law, Article 63. [2] *Ibid.*, Article 5. [3] *Ibid.*, Article 7.
[4] *Ibid.*, Article 8, paragraph 2. [5] *Ibid.*, Article 27. [6] *Ibid.*, Article 12.

Constitution lays down that the main function of the bank possessing the note-issuing monopoly is to regulate the country's money circulation, to facilitate payment transactions and to pursue, within the limits set by Federal legislation, a credit and monetary policy serving the interests of the country as a whole. These provisions were taken over into Article 2 of the National Bank Law from Article 39 of the Constitution and extended by an addition giving the National Bank the task of advising the Federal authorities on monetary matters. It was also laid down that the Confederation should entrust the central bank established by it with the carrying-out of its banking transactions. The Bank is thus obliged by law to perform the tasks allotted to it by the Confederation in the field of cash transactions, the coinage, the administration of moneys and securities, the investment of public funds, the administration of the national debt and the issue of Federal loans.

It is clear from the description of its main functions that the Swiss National Bank is responsible for Swiss monetary policy. It must pursue this within the framework of the legal provisions. These require that it should keep the gold value of the franc stable. At the same time it endeavours, in the interests of domestic economic equilibrium, to safeguard the purchasing power of the currency. The means at its disposal for carrying out these tasks are, however, limited (see Section V). Besides making use of the instruments provided by the National Bank Law, the Bank often pursues its policy by means of co-operation with the Federal Government and voluntary agreements with the banks and other credit-granting bodies.

III

STRUCTURE AND ADMINISTRATION

THE BANK'S CONTROLLING AUTHORITIES

The authorities which control the Swiss National Bank fall into three groups: the General Meeting of shareholders, the Bank authorities and the management.[1]

THE GENERAL MEETING OF SHAREHOLDERS[2]

The Ordinary General Meeting takes place once every year. It is convened by the President of the Bank Council, who also acts as Chairman of the Meeting. All shareholders entered in the shareholders' register are entitled to take part. Representation by another shareholder is permitted. Every share in principle entitles the holder

[1] National Bank Law, Article 28. [2] *Ibid.*, Articles 29–39.

to one vote. A private shareholder may not, however, as already mentioned, cast more than one hundred votes in respect of his own shares and those he represents. In accordance with the Bank's special tasks as a body entrusted with public functions largely pertaining to the state, the powers of the General Meeting are more limited than those of the general meeting of an ordinary joint-stock company under Swiss private law. They are mainly confined to receiving the annual report and the year's accounts (which must first be approved by the Federal Government),[1] allocating the net profit in accordance with the legal provisions, electing fifteen members of the Bank Council and electing the Committee of Auditors, deciding on increases in the Bank's capital—subject to the approval of the Federal Parliament—and the continued existence or dissolution of the Bank before the expiry of the note-issuing privilege, and also making such proposals as may be necessary to the Federal Government, for submission to the Federal Parliament, concerning the amendment of the National Bank Law.

BANK AUTHORITIES

The National Bank Law includes under the term 'Bank authorities' the Bank Council, the Bank Committee, the Committee of Auditors and the Local Committees.[2] A common feature of these authorities is that they are entrusted with functions of supervision and control. The fact that four bodies share this task is connected with the special legal structure of the Bank; when the latter was established it was necessary to take into account a large number of different interests, public and private, general and regional. The powers of the Bank authorities and their relationships to one another are for the most part laid down in the National Bank Law. It is left to the Bank Council to arrange the details by means of regulations which have to be approved by the Federal Government.[3] The term of office of members of the Bank authorities is four years, except for the members and deputy members of the Committee of Auditors, who have to be elected annually by the General Meeting. The members of the Bank authorities must be Swiss citizens domiciled in Switzerland.[4]

THE BANK COUNCIL[5]

The Bank Council is the body responsible for generally supervising the conduct of the Bank's business. It comprises forty members, of whom fifteen are elected by the General Meeting and the other twenty-five, including the Chairman and Vice-Chairman, are appointed by the Federal Government. The legal provisions stipulate

[1] National Bank Law, Article 25, paragraph 3. [2] *Ibid.*, Article 28.
[3] *Ibid.*, Article 61. [4] *Ibid.*, Article 55. [5] *Ibid.*, Articles 40–47.

that the various sections of the economy and the individual parts of the country, account being taken of the major banking, industrial and commercial centres, must be represented on the Bank Council. The law also requires, in order to safeguard the Bank from political influences, that the twenty-three members whom the Federal Government has to choose in addition to the Chairman and Vice-Chairman must not include more than five members of the Federal Parliament and five members of cantonal governments. The Bank Council is responsible in particular for choosing the new members of the Bank Committee, appointing the Local Committees, making proposals for submission to the Federal Government regarding the choice of members of the Directorate and their deputies and the managers of the Bank's branches, examining and putting into their final form the regulations, annual reports and yearly accounts which are prepared by the Bank Committee in conjunction with the Directorate (and which are subject to the approval of the Federal Government), fixing the denominations of the notes to be issued, withdrawing notes from circulation, deciding upon the establishment of branches and sub-branches, calling up the unpaid portion of the Bank's capital and deciding upon the fixing of discount ceilings over 5 million francs.

THE BANK COMMITTEE[1]

The Bank Committee is responsible for the more detailed supervision and control of the Bank. It performs this function on behalf of the Bank Council. The Bank Committee consists of the Chairman and Vice-Chairman of the Bank Council and eight other members of the Bank Council appointed by it. In designating the members of the Bank Committee care must be taken to see that the various parts of the country are represented; a canton may as a rule be represented by only one member. The Committee normally meets once a month. It has the duty of discussing in advance all matters to be dealt with by the Bank Council. It participates in an advisory capacity in fixing the official discount rate and the interest rate on loans. It is responsible for deciding on all matters which the law does not assign to another of the Bank's executive authorities. The Bank Committee makes proposals to the Bank Council, for submission to the Federal Government, regarding the choice of the members of the Directorate and their deputies and the managers of the Bank's branches, and chooses the other officials entitled to sign on behalf of the Bank. For the purpose of the day-to-day supervision of the conduct of the Bank's business the Bank Committee appoints from among its members Control Sections which

[1] National Bank Law, Articles 48–49.

it entrusts with the task of inspecting the Departments of the Directorate, the Bank's branches and its sub-branches. The periodical written and verbal reports made by the Directorate to the Bank Committee also facilitate the supervision of the conduct of the Bank's business. The Chairman and Vice-Chairman of the Bank Council are entitled to attend the Directorate's meetings. Close co-operation and contact between the Bank Committee and the Directorate are thus ensured; this facilitates the performance of the Bank Committee's supervisory functions and creates a link between the Directorate and a body composed of prominent representatives of the main sections of the economy.

THE COMMITTEE OF AUDITORS[1]

This is the auditing agency of the shareholders' General Meeting and consists of three members and three deputies. The Committee of Auditors has to audit the annual accounts and the balance sheet and submit to the General Meeting a written report on its findings, of which the Federal Government must also be informed. The Committee of Auditors is entitled to examine at any time all aspects of the Bank's business.

THE LOCAL COMMITTEES[2]

Attached to each of the Bank's two head offices and its branches there are Local Committees consisting of three members chosen by the Bank Council from among representatives of the business community of the centres in question and the surrounding districts. Their duties are mainly confined to expressing an opinion on recommendations to be submitted to the Directorate regarding the fixing of discount ceilings and to supervising the granting of discounts and advances by the Bank offices in question. In addition, the Local Committees attached to the branches have to give their opinion regarding the choice of the manager of the branch concerned and of the other officials entitled to sign on its behalf.

MANAGEMENT

THE DIRECTORATE[3]

The Directorate is the Bank's highest managing and executive body. Under the statutory regulations it is solely responsible for all action required for the fulfilment of the functions and purposes of the National Bank. It fixes the official discount rate and the interest

[1] National Bank Law, Article 51. [2] *Ibid.*, Article 50. [3] *Ibid.*, Articles 52–53.

rate on loans. All measures and decisions which have to be taken by the central bank in order to carry out its duties with regard to the regulation of the currency circulation and the organization of payment transactions and of credit and monetary policy are, subject to the powers of the Bank Council and the Bank Committee, the responsibility of the Directorate. It is the Directorate's duty to observe the state of the money and capital markets and the economic situation for the purposes of credit and monetary policy and to represent the Bank *vis-à-vis* other parties. The Directorate is also the body responsible for selecting the officials and employees of the Bank's head offices and its own sub-branches, in so far as they do not have to be appointed by the Federal Government or the Bank Committee, in which cases it submits nominations to the Bank Committee.

The Directorate is constituted as a board; it consists of three members, each chosen by the Federal Government to hold office for six years. From among the members of the Directorate the Federal Government appoints the President and Vice-President. In addition the Directorate includes deputy members, also elected by the Federal Government for six years on the recommendation of the Bank Council, and Section Directors, who are elected by the Bank Committee.

The internal organization of the Directorate is laid down in its basic outlines by the National Bank Law[1] and in greater detail by the Standing Orders for the Business of the Directorate and the General Secretariat, issued by the Bank Council and approved by the Federal Government. The Directorate has its seat in Zurich,[2] and its weekly meetings are usually held there. The chair is taken by the President, who is also entrusted, under the Standing Orders, with the following tasks. He takes the lead in the Directorate's dealings with the Bank's other controlling bodies. He sees to it that the decisions of the Bank Council, the Bank Committee and the Directorate are carried out. He arranges for the necessary preliminary work on proposals and reports to the Bank authorities and puts forward the Directorate's credit and monetary policies in these bodies. And he represents the National Bank *vis-à-vis* outside parties, unless the Directorate commissions another of its members to do so. The Directorate also has attached to it a General Secretariat, which has the duty of keeping the records of the Directorate, the Bank Council, the Bank Committee and the General Meeting, of doing the secretarial work for these bodies, and of keeping the shareholders' register.

For the preparation and execution of the Bank's operations the Directorate divides between itself the responsibility for three Departments, each of which is headed by a member of the Direc-

[1] National Bank Law, Article 53, paragraph 4. [2] *Ibid.*, Article 3, paragraph 2.

torate. The First and Third Departments have their seat in Zurich and the Second Department is in Berne.[1]

The following are the main functions allotted to the First Department, whose head is at the same time Chairman of the Directorate:

1. Investigations and the giving of expert opinions on economic matters, especially monetary and central-bank problems.
2. Statistics.
3. Legal matters.
4. Organization, staff, pension and welfare arrangements.
5. Bank premises.
6. Supervision of the head offices, branches and the Bank's own sub-branches.
7. Ensuring that the National Bank's rights and obligations under the Federal Law concerning Banks and Savings Banks are respected (see page 287).

The Second Department is entrusted with the following main duties:

1. The issuing of bank-notes.
2. The management of the central cash office and the administration of the Bank's gold holdings.
3. Gold operations.
4. The management of the main accounting department.
5. Dealings with the Federal Administration and the Federal Railways.
6. Dealings in securities for account of the Bank and the Confederation.
7. Directing the Bank's participation in the issuing of loans.
8. Business in the Berne area.

The main activities allotted to the Third Department are as follows:

1. Discount business, preparatory work in connection with the fixing of discount ceilings, administration of the Bank's bill holdings.
2. Foreign exchange transactions, the purchase and sale of foreign bills, cheques, bonds and sight balances, and the supervision of the foreign exchange holdings.
3. Advances against securities.
4. Giro and clearing operations.
5. Dealings with correspondents at home and abroad.
6. Business in the Zurich area.

[1] National Bank Law, Article 3, paragraph 3.

As already mentioned, it is incumbent on all three Departments to keep a watch on the state of the money and capital markets and on the economic situation for the purposes of the Swiss National Bank's credit and monetary policy.

BRANCHES

Each branch is headed by a manager elected by the Federal Government on the recommendation of the Bank Council for a period of six years; this manager has to represent the branch *vis-à-vis* outside parties and is responsible to the Directorate for the conduct of its business.[1] The managers of the branches must act in accordance with the Directorate's instructions. Transactions which by their nature or scope go beyond the normal sphere of activity of the branch may be carried out only with the Directorate's consent.

WEEKLY RETURN AND OTHER PUBLICATIONS

Under the provisions of the National Bank Law the Swiss National Bank has to publish a weekly return showing the figures for its assets and liabilities.[2] By a decision of the Bank Committee the dates for these weekly returns are fixed at the 7th, 15th, 23rd and last days of each month.

The Bank publishes an annual report by the Directorate on the Bank's activities. In its present form this contains general observations on the economic and monetary situation in Switzerland and abroad. The report discusses in detail economic trends in Switzerland and the movement of the foreign exchange reserves, the foreign exchange market, central-bank credit, the money supply and the money and capital markets. It also contains the accounts for the year, with detailed notes on the individual items, information concerning the distribution of profits and a comprehensive statistical annex summarizing the weekly returns and giving information about the Bank's operations during the year under review and also the way in which its business has developed since its formation.

The Bank's Economic and Statistical Section publishes a monthly statistical report and also an annual analysis of the activities of the institutions which are subject to the Federal Law concerning Banks and Savings Banks.

[1] National Bank Law, Article 54.
[2] *Ibid.*, Article 16, paragraph 2.

IV

POWERS AND ACTIVITIES

NOTE ISSUE

Until 1891 the cantons had possessed the constitutional right to issue bank-notes. In that year, by an amendment to Article 39 of the Federal Constitution, the exclusive right to issue bank-notes and other similar money-tokens was conferred on the Confederation and at the same time it was laid down that the Confederation could exercise this right through a separately administered state bank or, subject to the right of repurchase, could transfer it to a specially created central joint-stock bank which was to be administered with its assistance and under its supervision. Not until 1907, however, when the Swiss National Bank was founded, did the unification of the note issue actually take place. The Confederation transferred to the Bank the exclusive right to issue bank-notes, and the Bank has thus possessed the note-issuing monopoly since its formation.

The Swiss monetary system is based on the gold standard.[1] The gold parity of the Swiss franc was established by the Federal Currency Law of December 17, 1952, as follows: 1 franc = 63/310 or 0·20322 . . grammes of fine gold, which corresponds to a value for gold of 4,920 40/63 francs per fine kilogramme. Article 21 of the National Bank Law of December 23, 1953, lays down that the Bank must redeem its notes in gold coins or gold bars at the legal price for gold. In Article 39, as amended, of the Federal Constitution provision is, however, made for the Confederation, in time of war or of disturbed monetary conditions, to relieve the Bank of this obligation and to declare its notes legal tender. Even if this obligation is done away with, however, the Bank is still bound, under Article 22 of the revised National Bank Law, to maintain the value of the franc at the prescribed parity and to observe, when buying and selling gold, the price limits fixed by the Federal Council.

The Bank's obligation to redeem its notes in gold, which had been suspended in September 1936 when the franc was devalued, was abolished, following the entry into force of the revised National Bank Law, by a decision of the Federal Government dated June 29, 1954. By the same decision the Federal Government also declared the National Bank's notes to be legal tender and imposed on the Bank the obligation to apply, when buying and selling gold, prices for delivery at Berne diverging by no more than 1½ per cent upwards or downwards from the price corresponding to the legal parity.

[1] National Bank Law, Article 21, paragraph 1.

On this basis and given the gold parity mentioned above the following gold prices are obtained: minimum Fr. 4,846·82, maximum Fr. 4,994·44 per fine kilogramme. The present purchase price for gold *loco* Berne is Fr. 4,869·80, which is 1·03 per cent below the parity. The National Bank normally sells gold to foreign central banks at the parity rate.

Under the revised National Bank Law the note-issuing privilege is conferred on the Swiss National Bank for a period of twenty years (previously ten years) on each occasion. It has to be renewed by a decision of the Federal Parliament.[1] In 1956 Parliament renewed this exclusive right of the Swiss National Bank for the period June 21, 1957, to June 20, 1977.[2]

The fixing of the denominations of the notes to be issued requires the approval of the Federal Government.[3] On June 29, 1954, the latter approved a decision of the Bank Council of the Swiss National Bank whereby the latter was to issue notes in denominations of five, ten, twenty, fifty, a hundred, five hundred and a thousand francs.[4] The size of the note circulation is governed in principle by what is required in view of the volume of transactions.[5] There is no fixed maximum for the note issue in the sense of a fiduciary limit. The Swiss National Bank is of course bound always to accept its notes at their nominal value in payment or for the formation of credit balances.[6]

Under the legal provisions the notes issued must be covered up to their full equivalent by gold, Swiss and foreign bills of exchange and cheques with a maturity not exceeding three months, sight claims on foreign countries, securities (Treasury bills and bonds of the Confederation and the Federal Railways, Debt Register claims, bonds of the cantons and state-guaranteed institutions and mortgage bonds of the Swiss central mortgage institutions with a maturity not exceeding two years) and current-account claims in respect of lending against bonds or gold.[7] The gold cover must amount to at least 40 per cent, and the minimum gold cover must be kept within the country.[8] At the end of 1962 the note circulation of 8,506·1 million francs was covered by the total eligible assets to the extent of 148·4 per cent, and to the extent of 135·7 per cent by gold alone.

[1] National Bank Law, Article 66, paragraph 1.

[2] Decision of the Federal Assembly concerning the renewal for the years 1957 to 1977 of the Swiss National Bank's exclusive right to issue bank-notes, dated December 4, 1956.

[3] National Bank Law, Article 18.

[4] Decision of the Bank Council concerning the nominal value of the bank-notes to be issued by the Swiss National Bank, dated June 29, 1954.

[5] National Bank Law, Article 17, paragraph 1.

[6] *Ibid.*, Article 20, paragraph 1.

[7] *Ibid.*, Article 19, paragraph 1.

[8] *Ibid.*, Article 19, paragraph 2.

Since May 30, 1940, the gold has been shown in the balance sheet at the price of Fr. 4,869·80 per fine kilogramme.

The Bank can withdraw notes from circulation with the consent of the Federal Government. The notes withdrawn must, however, be accepted in payment at their full nominal value by the Confederation's public cash offices (the Federal Cash Office and the cash offices of the Postal Administration, the Customs Administration and the Swiss Federal Railways) and by the offices of the National Bank for a further six months from the date of first publication of the withdrawal notice—which means that these notes can also be used for private payments during this period. The Swiss National Bank is moreover bound to honour withdrawn notes for a further twenty years from the date of the announcement of withdrawal.[1]

SCOPE OF OPERATIONS

In order to ensure that it shall have the freedom of action and flexibility which it needs for the performance of its functions with regard to money-market and monetary policy, the Swiss National Bank must confine itself mainly to short-term operations; in other words, it is only allowed to acquire assets which it can realize within a suitable period. The operations which it may perform are enumerated and circumscribed by the National Bank Law. It should be pointed out in this connection that the Law does not oblige the Bank to carry out certain transactions, but merely states that it is entitled to do so. The Bank is quite free, within the sphere of activity defined by the Law, to undertake or refrain from any given transaction.

ACCEPTANCE OF MONEY DEPOSITS

The Bank may accept money deposits; no interest is payable thereon.[2] An exception can be made to this principle for balances held by the Confederation; since the beginning of 1937, however, no interest has been paid on the Confederation's balances. Accounts are held with the central bank by banks, a number of private firms of a non-banking character, the Federal Administrations and individual depositors (including the Bank's officials and employees). At the end of 1962 the Bank's sight liabilities of this nature totalled 2,800 million francs. Of this amount 2,294 million francs represented the private economy's balances (including 2,160 million held by domestic banks), 356 million francs the accounts of Federal Administrations, 22 million francs those of individual depositors and 98 million francs those of foreign banks. The remaining

[1] National Bank Law, Article 24, paragraphs 1–3. [2] *Ibid.*, Article 14, Section 6.

30 million francs consisted of balances on accounts maintained for the purpose of operating the system of controlled payments with foreign countries.

DISCOUNTING

The Swiss National Bank discounts claims with a maturity not exceeding three months, namely: Swiss bills and cheques bearing at least two independent signatures of known solvency, Federal Treasury bills, cantonal or communal Treasury bills bearing the signature of a bank, Swiss bonds eligible as collateral and Federal Debt Register claims.[1]

The main type of paper eligible for discount is bills drawn in connection with commercial transactions. The so-called compulsory-stock bills (*Pflichtlagerwechsel*) occupy a special position among the bills held by the Bank. The Bank carries these in order to help to finance the building-up of stocks of essential commodities, having in 1948 expressed its willingness to the Federal Department for Economic Affairs to grant discounts to firms which, under an agreement concluded between the competent Federal authorities on the one hand and industry and the wholesale trade on the other, maintain such stocks for the purpose of safeguarding the country's supplies. The firms obtain these discounts by presenting three-month promissory notes, the currency of which can be extended. In place of the missing second signature on these bills, the Confederation gives the Bank non-interest-bearing 'rescriptions'. The agreement between the Bank and the Federal Department for Economic Affairs was modelled on earlier agreements of a similar nature.

ADVANCES AGAINST SECURITIES

The Swiss National Bank is authorized to grant current-account advances at up to ten days' notice against the security of Swiss bonds, Federal Debt Register claims, discountable bills and gold in bars or coins. Shares and participations in co-operatives are not eligible as security for such advances.[2]

VOLUME OF CENTRAL-BANK CREDIT

Generally speaking, the private economy and the public authorities have had only limited recourse to central-bank credit since the beginning of the 1930s. The market has had sufficient funds at its disposal to be able to satisfy most of the economy's credit requirements out of its own resources, so that central-bank credit—in

[1] National Bank Law, Article 14, Section 1. [2] *Ibid.*, Article 14, Section 4.

the form of discounts and advances against securities—has been used only to a moderate extent. In 1962 the average amount of central bank credit outstanding was 76 million francs, or 0·6 per cent of the Bank's balance-sheet total. Of this amount 60 million francs comprised holdings of Swiss bills—including 46 million francs of discounted compulsory-stock bills—and 16 million francs advances against securities. Since the autumn of 1946 the Confederation has made no use of its discount facilities. Such Treasury bills as have appeared in the Swiss central bank's return have been held as a result of rediscounting by the market.

FOREIGN EXCHANGE TRANSACTIONS

The Swiss National Bank is authorized to buy and sell foreign bills and cheques with two good signatures, easily realizable bonds of foreign governments, and foreign sight balances, subject to a maximum currency of three months for the bills, cheques and bonds.[1] The Bank keeps its investments abroad in the form of Treasury bills of governments (U.S. Treasury bills), bank acceptances and sight deposits with foreign central banks and commercial banks.

THE PURCHASE AND SALE OF SECURITIES

Under the revised National Bank Law of 1953 the Bank is permitted to buy and sell Treasury bills and bonds of the Confederation and the Federal Railways, Federal Debt Register claims, the bonds of cantons and cantonal banks and the mortgage bonds issued by the Swiss central mortgage institutions.[2] This represents an extension of the earlier provisions, which allowed only the purchase of quite short-term, easily realizable bonds of the Confederation, the cantons and foreign governments for the purpose of the temporary investment of funds. The object of authorizing the Bank also to carry out transactions in longer-term paper was to enable it to exercise a stronger influence on the market. The scope for open-market operations is, however, limited, in that the Bank may include in the note cover the securities which it is now authorized to buy and sell only in so far as they have not more than two years to run to maturity.[3] As before the amendment of the provisions in question, it may purchase longer-term paper only within the limits of its own funds.

In 1962 the Swiss National Bank took up short-term U.S. certificates of indebtedness expressed in Swiss francs to a total of 207 million francs.

[1] National Bank Law, Article 14, Section 3. [2] *Ibid.*, Article 14, Section 2.
[3] *Ibid.*, Article 19, paragraph 1.

SERVICES TO THE CONFEDERATION

In addition to performing its primary function as the country's central bank, the Swiss National Bank makes its services available to the Confederation and the latter's administrative departments. These services are many and various. They are defined in Articles 2 and 15 of the National Bank Law, and the more detailed rules governing the business relations between the Bank and the Federal Department of Finance and Customs, the Swiss Federal Railways and the Swiss Postal, Telegraphic and Telephone Administration are laid down in separate agreements between it and these bodies. All three agreements relate to payments, the circulation of coins, the safe custody of deposited assets and the servicing of securities. The agreement with the Federal Department of Finance and Customs lays down the arrangements for the Bank's co-operation in connection with the issue of Federal loans and Treasury bills and the Bank's keeping of the Federal Debt Register. The agreements with the Swiss Federal Railways and the PTT Administration also relate to the withdrawal of defective bank-notes by their offices.

GIRO AND CLEARING TRANSACTIONS

One of the Swiss National Bank's duties is to conduct the country's giro, clearing and collection systems;[1] these facilitate payments, especially cashless money transfers. In view of the wide area over which the Swiss banks and savings banks are scattered, the giro system is organized on a decentralized basis. The National Bank's two head offices, each branch and also the sub-branches, whether owned by the Bank or not, are independent giro offices in contact with one another. The giro accounts are kept free of charge. Account-holders are no longer required to hold minimum balances.

In its efforts to extend the giro system the National Bank has taken steps, *inter alia*, to speed up transfers and to link its own giro system with the postal cheque and postal transfer systems and the bank clearing system, thus also bringing together the payment streams concentrated in these systems and the sections of the economy which they serve. The bank clearing-house system was created by the banks in the years 1949 to 1954 as a new institution designed to facilitate payments. The main innovation was the creation of seven clearing centres through which interbank payments are channelled. Settlements take place in the first instance through these centres and finally via the giro system of the Swiss National Bank, at which the balances necessary for the carrying-out of the clearing operations must be held. In addition, the National Bank

[1] National Bank Law, Article 14, Section 7.

itself now acts as a clearing house for local banks. The link-up with the postal cheque system was achieved by an arrangement with the PTT Administration whereby transfers can be made free of charge from any postal cheque account to a giro account with the National Bank, and vice versa. Postal cheque offices are also authorized to give cheques on the National Bank instead of cash to persons presenting postal cheques for payment.

While the primary function of the National Bank's giro system is to facilitate transfers, the purpose of the clearing offices attached to the National Bank is the exchange and settlement of payments (through cheques, bills, etc.) between the banks participating in the clearing. At the end of 1962 there were eight clearing offices with altogether seventy-five members. The National Bank is a member of all the clearing offices; it is also responsible for directing them and for the day-to-day supervision of the clearing operations.

The security-clearing system performs a similar function as regards dealings in securities to that carried out by the clearing offices in connection with cheques and bills. Attached to the National Bank there are two central security-clearing offices, in Basle and Zurich respectively; at the end of 1962 they had altogether forty-six members. Securities sold on the stock exchanges have to be delivered to the security-clearing offices, whereupon the settlement is effected via their giro accounts at the National Bank. The security-clearing services handle only cash transactions.

Collection business, on the other hand, is much less important. Under the regulations in force local bills lodged by banks operating in the same place are excluded from collection, except for cheques and matured bills presented for collection by clearing banks and drawn on clearing firms. For years, therefore, the greater part, both in number and amount, of the cheques and bills lodged for collection at the offices of the National Bank have come from members of the clearing offices.

DEALINGS WITH CORRESPONDENTS IN SWITZERLAND

As mentioned earlier, the National Bank's regional organization is supplemented by a closely-knit network of correspondents.[1] These correspondents, who act as local paying agents of the National Bank, are of special importance in payment relations with the Postal Administration, the Swiss Federal Railways and various offices of the Federal Administration. Today practically all the money transactions between the central offices of these administrations and their local offices take place through the National Bank

[1] National Bank Law, Article 14, Section 8.

and its network of correspondents. A correspondent's in-payments and out-payments are passed through a correspondent account, in the name of the National Bank, kept by the correspondent in question. The correspondent has to pay interest on the National Bank's balances on the correspondent account and must settle them twice a month. To ensure that its liabilities to the National Bank will be met, the correspondent—except in the case of government-guaranteed institutions—has to furnish a security. The expenses incurred by a correspondent in carrying out its functions are reimbursed by the National Bank.

SUBSIDIARY ACTIVITIES

In addition to the operations to be carried out by the Swiss National Bank in the performance of its main functions, the National Bank Law also lists some which are not directly connected with the Bank's rôle as a central bank.[1] These subsidiary activities include the custody, administration, purchase and sale of securities for account of others, the acceptance of subscriptions to Federal and cantonal loans, the acceptance of money deposits on non-interest-bearing accounts and the hiring-out of safe-deposit boxes. The National Bank thus makes available to the public some services which are similarly performed by other banks. These subsidiary activities have been carried out only on a small scale, since the National Bank has wished to avoid encroaching on the other banks' field of operations. Considerations of profit have never been a prominent aspect of these activities.

CONTROL OVER SECURITY ISSUES

In Switzerland domestic bond and share issues are not subject to authorization. Publicly-issued loans are usually placed on the market by loan-issuing groups. Thus the big Swiss banks, the Cantonal Bank of Berne and the Geneva private bankers combined to form the Swiss Banking Cartel for loan-issuing purposes, and the cantonal banks (other than that of Berne) joined forces in a second issuing group. For issues to be placed jointly the two groups have united to form one issuing syndicate.

With regard to foreign issues, the institutions subject to the Federal Law of 1934 concerning Banks and Savings Banks are required to notify the Swiss National Bank in advance of any loan which they propose to issue on the Swiss market or which they have

[1] National Bank Law, Article 14, Sections 12–13.

themselves taken up, of the granting of credits to foreign borrowers for periods of twelve months or more and of the taking-up or issuing of shares of foreign companies, if the sum involved is 10 million francs or more. The National Bank may, in the light of currency, interest rate or general economic conditions in Switzerland, veto such operations or dictate the terms on which they are to be carried out. If it appears desirable in view of the state of the money market or the economic situation, the Bank can also demand to be advised of operations involving sums of less than 10 million francs.[1] The Swiss National Bank decides its attitude towards such projects on the part of the banks solely in the light of money-market and capital-market conditions and of the state of the currency. The safeguarding of the country's economic interests is not the direct concern of the Bank, but is the responsibility of the Federal Government's competent Departments, which are kept informed by the National Bank of capital export transactions requiring authorization and are invited to give their opinions.

FOREIGN EXCHANGE CONTROL

The first official measures of intervention in Swiss payments with foreign countries were taken in the early 1930s, when a number of countries introduced foreign exchange control and Switzerland was obliged, in order to protect itself against the discriminatory effects of the exchange restrictions applied abroad, to make payments with certain of these countries subject to inter-governmental arrangements. The legal basis was provided in the first place by the Federal Act of December 23, 1931, concerning the Limitation of Imports and subsequently, until the end of 1956, by the Federal Act of October 14, 1933, concerning Economic Measures in Relation to Foreign Countries. The latter Act authorized the Federal Government to safeguard Swiss interests *vis-à-vis* countries whose payments were subject to restrictions by concluding short-term agreements with these countries. If such agreements could not be reached, it was authorized to protect Swiss interests by means of unilateral measures, including in particular restrictions on payments. On this legal basis the regulations governing the system of controlled payments were evolved and perfected. In 1956 the provisions scattered in numerous ordinances of the Federal legislature, the Federal Government and government departments and the rules of jurisprudence on these matters were brought together and uniformly codified in the Federal Government Decision of December 17, 1956, on Economic Measures in Relation to Foreign Countries, based on the Federal Act of

[1] Federal Law concerning Banks and Savings Banks of November 8, 1934, Article 8.

September 28, 1956, concerning Economic Measures in Relation to Foreign Countries. Switzerland has never had to introduce foreign exchange restrictions because of inadequate monetary reserves.

Originally the Swiss National Bank undertook to implement the clearing agreements itself. But the increase in the number of such agreements and the work of ensuring that they were observed necessitated constant additions to the Bank's staff. Because of this and because the system of controlled payments had been introduced as a defence against foreign measures detrimental to Swiss economic interests, the Bank subsequently requested the Federal Department for Economic Affairs to establish a proper clearing office. Such a body was formed in 1934 under the name of 'Swiss Clearing Office' (Schweizerische Verrechnungsstelle). Its members comprised—apart from the Confederation—the Swiss National Bank, the Central Committee of the Swiss Association of Commerce and Industry (the central industrial and trade organization), the Swiss Bankers' Association and the Swiss Central Office for the Promotion of Trade. The functions of the Swiss National Bank's Clearing Section were transferred to the new body. The National Bank continued, however, to keep the clearing accounts on behalf of the Clearing Office. The Clearing Office has now become, by virtue of the above-mentioned Federal Act of September 28, 1956, an institution incorporated under public law. The Swiss National Bank is represented on its Board of Management (the Swiss Clearing Board) and its executive committee. When at the end of 1958 most of the countries belonging to the European Payments Union introduced convertibility for non-residents, the Federal Government decided to abolish the system of controlled payments *vis-à-vis* these countries (or monetary areas). Since then payment relations with further countries have been freed from restriction. As a result the Swiss Clearing Office's field of activities has been greatly reduced.

In Switzerland the advances made under clearing and payment agreements were granted not by the central bank but by the Confederation. The Swiss National Bank would have been precluded, for monetary and legal reasons, from making these advances. It had to avoid having any part in the creation of means of payment as a result of the granting of foreign credits, since owing to the way payments developed the credits extended to the countries which were parties to the agreements were of a long-term nature.

RELATIONS WITH THE BANKS

In principle, the relationship of the banks to the Swiss National Bank is that of customers. The Swiss National Bank has no legal right to supervise or direct the banks' activities, other than the

powers mentioned below. In particular, it does not have at its disposal the instrument of compulsory reserves possessed by some other central banks.

The Swiss credit institutions enjoy great freedom of action. Thus the Federal Law of November 8, 1934, concerning Banks and Savings Banks has as its main object not the supervising of the banks' credit activities but the protection of their creditors. The Law, together with its implementing ordinance, contains regulations for the organization of the credit institutions, the conduct of their business and the supervision of their activities. The highest supervisory and executive body is the Federal Banking Commission, which comprises five members chosen by the Federal Government. The Swiss National Bank is not represented on this body. Ever since its creation, however, the Commission has maintained close contact with the central bank. It informs the National Bank of its decisions of principle and asks for the Bank's views before discussing questions of interest to it.

The banks hold balances at the National Bank as part of their liquid resources; they make use of these for transfers to other accounts held at the central bank or for withdrawing bank-notes. The central bank lends to the banks through its discount operations and its advances against securities, and it also renders them important services through its leading rôle in the execution of cashless money transfers, whose growth it has always endeavoured to promote.

Various obligations of the banks to the National Bank are laid down in the above-mentioned Federal Law concerning Banks and Savings Banks. Mention has already been made of the rule requiring them to notify the National Bank of proposed capital export transactions. The banks are also required to submit to the central bank their annual accounts and balance sheets and, in connection with this, to supply it with adequate information concerning the composition of their foreign assets and liabilities.[1] Furthermore, the National Bank is given a right to participate in decisions regarding the raising of the interest rate on medium-term bank bonds (*Kassenobligationen*),[2] in that banks with a balance-sheet total of 20 million francs or more which propose to raise the interest rate on their medium-term bonds must inform the Swiss National Bank at least two weeks in advance. The Bank examines the proposals in the light of the possible effects on the country's economic interests, the formation of interest rates on the money and capital markets and the legitimate interests of the bank in question. The National Bank is thus able to do something towards preventing or postponing interest rate increases which it considers undesirable.

[1] Federal Law concerning Banks and Savings Banks, Article 7.

[2] *Ibid.*, Article 10.

The manner in which the National Bank influences the banks' business operations by obtaining their voluntary co-operation is discussed in the next chapter.

RELATIONS WITH INTERNATIONAL INSTITUTIONS

The Swiss National Bank is a shareholder of the Bank for International Settlements. It was authorized by a Federal Act dated June 26, 1930, to participate in the capital of the B.I.S. and to exercise the rights acquired thereby.

During the period of operation of the European Payments Union the Swiss National Bank, acting for the Confederation, kept the accounts in the names of the central banks of the other member countries. It now acts as the agent of the Confederation for the execution of the European Monetary Agreement.

It should be added that Switzerland is not a member of the Bretton Woods institutions (the International Monetary Fund and the International Bank for Reconstruction and Development).

V

MONETARY POLICY

GENERAL

The main task allotted to the Swiss National Bank by the Constitution and by law, namely that of pursuing a credit and monetary policy serving the interests of the country as a whole,[1] is to be interpreted as meaning that the Bank is responsible for keeping the gold value of the Swiss franc stable and, as far as the means at its disposal permit, for safeguarding the internal value of the currency. The performance of this dual task is rendered particularly difficult from the very outset because the Swiss economy has extremely close links with that of the rest of the world and is constantly exposed to strong external influences. Switzerland usually has substantial balance-of-payments surpluses on current account and during recent decades there have been large-scale capital movements into the country. These two external factors have, of course, by affecting the money supply, further increased the liquidity of a market already amply supplied from domestic sources. Consequently the basic aim of the Swiss National Bank's monetary policy has as a rule been and is also at present to keep market liquidity in check. The instrument of discount rate policy given to it by the National Bank Law and the very limited possibilities of open-market operations are not, however, sufficient to enable it to achieve its statutory

[1] National Bank Law, Article 2, paragraph 1.

aims; it therefore has to rely on government co-operation and the support of the banks.

That the policies pursued have not been ineffective is shown by the relatively slight decline in the purchasing power of the Swiss franc. One of the reasons for this, apart from the effects of the market policy pursued by the central bank and the Confederation, is that Swiss importers have always been able to buy in the cheapest markets, since Switzerland, thanks to the National Bank's large monetary reserves, has not needed to impose import restrictions in order to save foreign exchange. Another particularly important factor has been the wage policy of the trade unions, which, generally speaking, have been moderate in their claims for pay increases and have shown understanding, in leading branches of the export trade, for the interests of the economy as a whole. Mention should also be made of the liberal policy adopted with regard to the admission of foreign labour, which has slowed down the rise in wage costs. The principal and most effective factor in curbing the forces of monetary expansion, however, has been the Confederation's financial policy. This has been aimed at supporting the Swiss National Bank in its efforts to maintain the value of the Swiss franc and at giving practical help in keeping down the money supply. One of the objects of the Confederation's policy has been to achieve surpluses during periods of boom. A fact of special importance in this connection has been that the surpluses achieved in years of intense economic activity have not been used to repay debt, but have been sterilized and so removed from the economic circuit. The resources thus sterilized amounted at the end of 1956, after deduction of the operating funds required for the Federal Treasury and the amounts from creation-of-work reserves, to about 1·1 milliard francs. After having restored the major part of its sterilized funds to the market in 1957 and 1958, the Confederation in 1960 and, in particular, 1961 and 1962 again helped to reduce the active money supply by continuing to limit debt repayment and by leaving part of its cash budget surpluses on deposit with the National Bank and investing part abroad. At the end of 1962 the Confederation's freely available funds totalled 1·8 milliard francs.

INSTRUMENTS OF MONETARY POLICY

The instruments which the Swiss National Bank employs to influence the money market are listed below. The order in which they are given reflects neither their effectiveness nor the sequence in which they have been used. The main instruments are:

1. Credit policy
   (*a*) Discount rate policy
   (*b*) Policy as regards secured advances

2. Open-market policy
3. Gold and foreign exchange policy
4. The influencing of market interest rates
5. The control of capital exports
6. Recommendations to banks and other credit-giving bodies
7. The conclusion of gentleman's agreements.

DISCOUNT RATE POLICY

Discount rate policy as an instrument of market policy was for a long time of little importance in Switzerland. This is clear from, *inter alia*, the fact that for more than twenty years—from the end of November 1936 until mid-May 1957—the Swiss National Bank's official rates remained unchanged, the official discount rate at 1½ per cent and the rate for secured advances at 2½ per cent. The decline in the amount of paper presented for discounting, in other words the meeting of credit requirements otherwise than by the discounting of bills, together with the high degree of liquidity which has existed—with only rare and temporary exceptions—since the 1930s, have loosened the close connection which used to exist between the drawing of bills by the economy and the creation of money by the central bank. The system of cashless transfers has grown and self-financing has come to play a more important part in the economy.

When in the spring of 1957 it grew more evident that the boom was becoming excessive in Switzerland, the Directorate of the National Bank raised the discount rate on May 15th from 1½ to 2½ per cent. It was obliged to do so by the prevailing trend of interest rates and the tendency of Switzerland's current balance of payments with foreign countries to run into deficit. After various market rates had been showing an upward trend for months, an adjustment of the official National Bank rates to the changes in money-market conditions became unavoidable. The raising of Bank rate was also intended, however, to bring home to the private economy and the public authorities the fact that there had been a change in the market situation. That the National Bank had resorted to the instrument of discount rate policy for the first time in over twenty years was an event that had a great psychological effect. When, subsequently, there was a fresh increase in market liquidity, accompanied by a decline in interest rates, the Swiss National Bank adjusted its official discount rate to market conditions by lowering it—in February 1959—to 2 per cent.

The National Bank has only one official discount rate. It can apply special rates, however, to the discounting of bills resulting from the financing of officially prescribed compulsory stocks. Under

this arrangement the Bank at present discounts promissory notes made out by holders of stocks of foodstuffs and feeding stuffs at a rate of 1¾ per cent, which has been agreed between the banks and the Federal authorities responsible for the maintenance of the compulsory stocks. Although borrowing from the Swiss National Bank is on a small scale, the Bank was anxious in 1958 to make use of its portfolio of compulsory-stock bills to draw off funds from the market. It was also strongly influenced by its opinion that the long-term financing of stocks was not a proper activity for a central bank. It therefore reduced its holdings of compulsory-stock bills from 132 million to 52 million francs in the course of the year.

The idea that the central bank should lend only at short term so as to preserve its freedom of action has always been the guiding principle underlying the Swiss National Bank's granting of credit to the public authorities. Thus the Bank made its provision of credits against 'rescriptions' subject to the proviso that the debt should be funded within a short time by the issue of a loan; and during the Second World War the Bank's management made it its foremost aim to avoid constant lending to the government and to prevent, in the interests of maintaining economic equilibrium, any inflationary creation of money. The government's requirements were met by the raising of new taxes, the issue of long-term loans and the placing of Treasury bills on the market. The Swiss National Bank was able to confine itself to providing the government with temporary credits, the amount of which, however, was nowhere near as large as in the First World War. They were always at short term, as the government took pains to repay as quickly as possible its borrowings from the Bank against rescriptions.

The Swiss National Bank also exercises great restraint in meeting the financial requirements of the cantons and communes. Their short-term needs are satisfied by the cantonal banks and other credit institutions, which sometimes impose the condition that the Treasury bills they take in must be rediscountable at the central bank, thus enabling the latter to exert an indirect influence on the cantons' and communes' short-term borrowing. The rediscounting of such paper is in principle reckoned against the rediscount limit of the bank which presents it.

POLICY WITH REGARD TO SECURED ADVANCES

Lending against collateral, i.e. the granting of interest-bearing advances against the pledging of security, was originally regarded merely as being complementary to discounting. In recent years, however, it has become more important than the latter. Since there has often not been sufficient discountable paper available and since

local banks and savings banks have hardly any at all, advances against bonds are in fact the only way in which these institutions can obtain funds from the central bank. Many banks therefore keep at the National Bank quite large deposits of securities against which they obtain credit. As the recipient of such secured advances is always entitled to repay the whole or part of his debt, the National Bank lays down, for end-of-month advances, a minimum number of days for which interest is payable, with the object of preventing the customer from resorting to secured advances in cases where he ought to discount. The ten days' period of notice for secured advances is intended to prevent the abuse of this form of credit for purposes such as speculation on the stock exchange.

Until the period following the First World War the rate for secured advances was as a rule ½ per cent above the official discount rate. Since then the difference has been practically always 1 per cent. Changes in Bank rate and the rate for secured advances have virtually always coincided.

OPEN-MARKET POLICY

The Swiss National Bank is confined within narrow limits with respect to open-market policy, in the sense of the buying and selling of government bonds on the market. The Bank's scope for open-market operations was not increased until 1953, when the revised National Bank Law authorized it to include in the note cover securities and bills with up to two years to run. The reason why Parliament would not give the Bank wider powers was that Article 39 of the Federal Constitution allows only short-term assets to be included in the note cover in addition to gold. It was probably also thought that the limitation of the central bank's possibilities of intervention might at the same time serve to protect it against any demand from the government that it should exercise systematic control over the capital market and the formation of interest rates. Up to now the Swiss National Bank has not even been able to make use of these limited powers, since the high degree of market liquidity which has existed for many years has made it impossible for the central bank to buy bonds for its own account on the market and thus build up a reserve for open-market operations.

The Swiss National Bank has, however, as far as permitted by the National Bank Law, made use of open-market operations for many years, though not by the purchase and sale of long-term paper. It has done this mainly by buying and selling gold and foreign exchange, Treasury bills and easily realizable bonds.

As far back as the First World War, but more particularly since the outbreak of the Second, the Bank has sold Treasury

bills on the market in order to mop up funds. Most of these bills have been placed on behalf of the Confederation; only to a small extent has the National Bank been able to sell marketable paper from its own holdings. Federal Treasury bills, usually bearing an assurance of rediscount, are a first-class liquid investment popular with the banks. Conversely, they enable the National Bank to exercise, in connection with their redemption or renewal, whatever influence it considers called for by the situation and by the trend of interest rates. The total amount of Federal Treasury bills outstanding, most of which are held by banks and do not change hands, has been reduced by redemptions from about 1·1 milliard francs at the end of 1944 to about 900 million francs at the end of 1962.

In the years 1947–49 rescriptions of a special kind—sterilization rescriptions—were issued. These were instruments created for the sole purpose of reducing the money supply and immobilizing liquid resources. The National Bank did not make the countervalue of these rescriptions freely available to the Confederation, but credited it to a blocked account which was shown in the Bank's statement as a special item entitled 'Time liabilities'. The interest required on the rescriptions was paid by the Swiss National Bank out of its own funds. On October 1, 1960, again with the object of skimming off funds from the market, sterilization rescriptions to a total of 400 million francs were placed with the banks. Their currencies ranged from nine to eighteen months and their interest rates from 1 to 1¼ per cent, the National Bank again bearing the interest charge in respect of this operation. In 1961 and 1962 the sterilization rescriptions were renewed as they reached maturity.

In those years too, having to take up large amounts of dollars as a result of substantial inflows of funds from abroad, the National Bank sought to counteract the consequent increase in market liquidity by means of monetary operations with foreign central banks. Thus, in the summer of 1961, it put at the disposal of the Bank of England within the framework of various swap transactions gold against pounds sterling at two to three months, and made available the sterling covered forward in this way—totalling £40 million—to the Confederation and the Swiss banks for short-term investment in the United Kingdom. In 1962 it was able by way of various monetary operations with the Federal Reserve Bank of New York and the Bank for International Settlements in Basle to skim off a total of approximately 600 million francs from the market and to channel it out of the country again via the banking system.

GOLD POLICY

The strong position of the Swiss franc finds visible expression in

the size of the gold cover. Since the devaluation of the franc in September 1936 no steps have had to be taken to protect the gold reserves. Many measures, on the other hand, have had to be adopted to stem and ward off an excessive influx of gold and foreign exchange. This is true especially of the years since 1940. It is difficult for the Swiss National Bank to prevent an unwelcome inflow of gold and foreign exchange. Although not obliged to purchase gold, it is bound to accept, to the extent necessary for the performance of its task of keeping the currency at parity, the gold and exchange tendered to it.

During the Second World War and in the early post-war period the Swiss National Bank had to take action to counter not only an excessive inflow of dollars (see page 295) but also substantial offerings of gold. Foreign buyers were keen to acquire Swiss francs, since the franc was one of the hardest currencies. But by selling francs for gold or foreign exchange the National Bank was creating new money, and in view of the dwindling supply of goods at that time there was a danger of an inflationary rise in the price level. The Bank therefore resorted to selling gold on the market as a means of skimming off surplus funds. From the beginning of 1940 until September 1947, with only short interruptions, altogether 1·4 milliard francs' worth of gold in the form of bars and of Swiss and foreign gold coins was placed on the market. Another object of the National Bank's sales of gold on the market was to regulate the price of gold. They only served a purpose, however, so long as they absorbed domestic means of payment, i.e. so long as the market bought the gold for hoarding purposes. But when, as a result of the movement of gold prices abroad, the gold offered by the National Bank stopped being hoarded in Switzerland and was instead sold to foreign buyers, the selling of gold lost its monetary purpose and was therefore suspended. Until 1955 the margin which existed between the legal parity and the high prices temporarily ruling on foreign gold markets prevented the use of gold as an instrument of market policy. By the beginning of 1955 the time had come to make use of this weapon again, since in view of the price situation on the gold market there was no longer any danger that the gold coins which were sold to the public at the parity rate—and which, in compliance with the Currency Law of 1931, were old ones—would flow into the channels of international speculation. Gold coins to the value of 75 million francs were sold in the course of this operation.

From the spring of 1943 onwards the National Bank, in addition to selling gold on the market, also passed on part of the influx of gold to the Confederation. The Federal Government had expressed its willingness to assist by accepting some of the gold received, especially that relating to non-commercial foreign payments. The central bank created no new money in respect of the gold taken

over by the Confederation. Part of the countervalue was paid with Federal funds and part was blocked. The amount of gold passed on to the Confederation reached its peak—1,258 million francs—at the beginning of 1947. Gradually this gold was taken back by the National Bank, except for an amount of 250 million francs which the Confederation had to pay to the Governments of France, the United Kingdom and the United States in 1946 under the Washington Agreement.

EXCHANGE RATE POLICY

During the Second World War, when the Swiss National Bank had to combat an undesirable growth in the money supply, its most effective defence against a flooding of the market lay in refusing to accept and automatically convert into Swiss currency the whole of the economy's foreign exchange receipts. In the autumn of 1941 the National Bank found itself obliged to limit the conversion of dollars into Swiss francs to export earnings and to introduce a system of control of dollar assets. It concluded a gentleman's agreement with the banks concerning both the use of dollars to pay for imports and its acceptance of the dollar proceeds of exports; it refused on principle to accept dollars derived from capital earnings and capital transfers. From 1943 onwards the conversion of dollar export proceeds was also restricted. The fact that only dollars from certain sources were accepted by the Swiss National Bank at the official rate led towards the end of 1946 to the formation in Switzerland of a parallel market in which the dollar was dealt in at a rate below the official parity. There thus came into being the so-called financial dollar. Not until the post-war years was the National Bank able gradually to dismantle its dollar controls. And then in the autumn of 1949 the devaluations effected by leading European countries, whereby unrealistic exchange rate relationships were corrected, gave it a welcome opportunity of removing all restrictions on the acceptance of dollars.

In the period 1950–58 the foreign exchange situation, from Switzerland's point of view, was characterized by the co-existence of two different currency areas shut off from one another. On the one hand Switzerland was a member of the E.P.U. It participated with its fellow member countries of the Union in a multilateral clearing system under which currency balances were offset against each other at rates derived from the dollar parities of the individual currencies; the parity for the Swiss franc is 4·37 to the dollar. On the other hand the Swiss franc, as a convertible currency, was freely exchangeable against the dollar. As Switzerland usually achieved balance-of-payments surpluses in its dealings with the dollar area

and as the formation of exchange rates was governed by the laws of the free market, the dollar, in view of the fact that the supply of dollars exceeded the demand for them, was subject to a certain pressure and generally remained at the National Bank's minimum buying rate of 4·285. There thus developed between the dollar, on the one hand, and the E.P.U. currencies in relation to the Swiss franc, on the other, an exchange rate differential of 2 per cent, which would sometimes have been even greater if the National Bank had not supported the dollar at the above-mentioned lower limit. An evening-out of the two rate levels was not possible under the E.P.U. system, since the E.P.U. currencies, apart from the Swiss franc, were not convertible *vis-à-vis* the dollar, and furthermore the amounts in francs accruing in Switzerland under the system of controlled payments could not be converted into dollars. The return of thirteen member countries of the European Monetary Agreement to non-resident convertibility removed the barrier, and this inevitably led to a levelling-out of the above-mentioned exchange rate levels and a modification of exchange rates in Switzerland. The limits within which this adjustment could take place were set primarily by the Swiss National Bank's buying and selling rates for the dollar. The Bank revised these rates, putting the lower limit for the purchase of dollars at 4·295 and the upper limit for the sale of dollars at 4·45.

CAPITAL EXPORT POLICY

In its power to veto or impose conditions on the banks' capital export transactions the Swiss National Bank possesses a valuable weapon of market policy which has on several occasions proved a welcome addition to its limited armoury. In view of the fact that the market has generally been well supplied and at times even flooded with funds, the National Bank has been liberal in giving permission for the issuing of foreign loans on the Swiss market and the granting of bank credit to foreign customers, provided that the operations in question have been in accordance with the country's economic interests. For Switzerland the export of capital plays an essential part in maintaining economic equilibrium; it helps to offset the balance-of-payments surpluses which Switzerland usually earns on current account, and also has the effect of reabsorbing foreign hot money. The central bank is, however, authorized by law to curb the outflow of funds to foreign countries if the domestic market becomes strained, in order to prevent savings and reserves of capital from leaving the country at times when the domestic market needs them. Thus in the summer of 1956, when the market became increasingly tight, the Swiss National Bank advised the banks temporarily to cease submitting applications for permission to export capital; from

August 1958 onwards the placing of new foreign issues on the market was again permitted. In 1962 the National Bank, having regard to the heavy capital requirements of Swiss borrowers and the slightly tighter market conditions, brought about a distinct slowing-down in the rate of foreign loan issues.

VOLUNTARY AGREEMENTS WITH THE BANKS

As the instruments of market policy with which the legislature has equipped the Swiss National Bank are limited, recommendations to the banks and agreements with them play an important part in the Swiss central bank's market policy. The co-operation based on voluntary agreements with the banks is also in harmony with the liberal principles which are a feature of the Swiss economic system. The Swiss National Bank has thus repeatedly asked the banks for their co-operation in dealing with money-market and capital-market problems, both actual and potential.

There are many ways in which the behaviour of the banks can be influenced. In the address given by the President of the Directorate to the Annual General Meeting of shareholders the central bank's opinions on current questions are stated; the communiqués supplied to the press concerning the meetings of the Bank Council, usually held quarterly, provide an opportunity of drawing the attention of the banks and of a wider public to problems which affect the central bank. The National Bank also exerts an influence through its periodical conferences with leading representatives of the banks concerning the credit-market, monetary and economic situation. It has also repeatedly made known its opinions and wishes by means of circulars sent to all banks. Thus, for example, in December 1959 it urged the banks in a circular to pursue a cautious and selective credit policy, giving preference to publicly assisted house-building, and advised them to keep their liquid resources readily available so as to be able subsequently to honour the credit assurances given. The circular contained certain guiding principles regarding the granting of building credits, and finally the National Bank, concerned about the recent growth of investment trusts in Switzerland, recommended the banks to refrain for a while from establishing any more such bodies. It also conveyed its views on this point to the managements of the Swiss investment trusts in a special letter.

A more effective means of influencing the banks' credit-granting is provided by gentleman's agreements. The first agreement of this kind, whereby the banks expressed their willingness to notify the central bank when they proposed to issue a foreign loan, was concluded in 1927. In the 1930s the subjects of such agreements

included the interest rates on bank bonds (*Kassenobligationen*), measures against currency speculation, the foreclosing of mortgages, foreign-held Swiss franc balances, the hoarding of bank-notes and stock exchange dealings in foreign securities. During the Second World War agreements were in force concerning dollar transactions and dealings in gold. Special mention should be made of the recent gentleman's agreements regarding the financing of building, the minimum balances of banks and insurance companies and the treatment of foreign funds in Switzerland, and the conclusion of an agreement with the banks on the restriction of credit.

The gentleman's agreement on the financing of building came into force on August 1, 1951. Under this arrangement the banks, insurance companies and other credit-granting bodies participating in it—they numbered over 1,600—undertook to obey certain guiding principles and observe certain upper lending limits, their compliance with these provisions being supervised through a central trust agency controlled by the Swiss National Bank. Building loans were not as a rule to exceed 70 per cent of the estimated cost; the same limit also applied to the granting of mortgage loans. The agreement, which was first concluded for one year and subsequently renewed several times, helped to prevent an excessive expansion of the volume of building credit and, in particular, to set certain limits to speculative building. In 1957, when there was a decline in bank lending due to the tightness of the capital market, the further application of these provisions became unnecessary. The agreement was therefore discontinued with effect from July 31, 1957.

As the Swiss National Bank's means of action do not include compulsory reserves, it tried in 1955 to immobilize market resources by means of a voluntary agreement with the banks. This agreement was designed to bring about the adoption by the private economy of a measure which might be regarded as a counterpart to the action taken by the Confederation, in the light of its correct assessment of the increasing liquidity of the market, in sterilizing the Federal budget's cash surpluses. The parties to the agreement comprised all banks with a balance-sheet total of 50 million francs or more. The minimum balances which every participating bank had to hold on a special blocked account at the central bank were fixed for each bank according to the ratio of its short-term liabilities to its total liabilities, so that commercial banks had to put up larger minimum balances than mortgage banks. In addition to the banks, insurance companies and public social security institutions were required to form cash reserves. At the end of September 1956 these blocked funds totalled 370 million francs. The Swiss National Bank endeavoured from the outset to apply this minimum reserve policy in a flexible manner, although the agreement itself did not provide for

variable reserve ratios. Thus in the autumn of 1956, when the capital market became tight, the Bank released half of the minimum balances, with the intention of requiring these to be brought back to their original levels in February 1957; it then actually confined itself, however, to calling in again only half the released funds. In June 1957 the agreement with the banks was renewed for an indefinite period, while the insurance companies, which were particularly affected by the reduction in available resources, withdrew from the scheme. In the autumn of 1957 a further portion of the banks' minimum balances was released, and in March 1958, when the economic climate had cooled off appreciably, the remainder, too, was freed.

Also in 1955, an agreement was concluded between the National Bank and the banks with a view to checking the inflow of short-term foreign funds. A similar arrangement had already been introduced in 1950, but had been suspended in 1951. Unlike the agreement on minimum balances, which had applied only to medium-sized and large credit institutions, this one covered all the members of the Swiss Bankers' Association, which was also responsible for the practical implementation of the agreement. Its main provisions were that no interest should be paid on foreign funds and that they should moreover be made subject to sixty days' notice of withdrawal. This agreement, which was linked with that on minimum reserves, was discontinued, like the latter, in March 1958. Its object was to ensure that the Swiss market should not be completely exposed to the inflow and outflow of floating foreign funds of the type which usually only seeks temporary refuge in Switzerland.

Action to ward off an inrush of funds again proved necessary in the summer of 1960, when, owing to the sudden deterioration of the international political situation, foreign money began to pour into Switzerland, while at the same time Swiss investments abroad were repatriated and foreign credits granted by Swiss banks were repaid. In order to curb this influx of funds and the resultant growth in bank liquidity, undesirable at a time of intense boom, on August 18, 1960, the National Bank again made a gentleman's agreement with the credit institutions. Its object is to create barriers against a further inflow of foreign funds and as far as possible to cause such money to be withdrawn again. Under this agreement foreign-held Swiss franc deposits formed since July 1, 1960, are subject to at least three months' notice of withdrawal. Furthermore, no interest is to be paid on them. On new foreign funds at less than six months' fixed term a commission of ¼ per cent per quarter is charged. The investment in Swiss securities, real estate or mortgage claims of foreign balances formed since July 1, 1960, is, wherever possible, to be prevented. Exceptions to these arrangements are provided

to enable the banks to carry out their normal commercial transactions and to continue to meet the requirements of their established foreign banking customers. The gentleman's agreement was supplemented by the placing of sterilization rescriptions with the banks in the manner already mentioned.

The gentleman's agreement aimed at warding off and reducing the volume of foreign funds was prolonged in 1961 for twelve months and in 1962 for a further six months.

In addition, thanks to the co-operation of the banks, with whom the funds which had entered Switzerland after the revaluations of the Deutsche Mark and the Netherlands guilder had been placed, it proved possible to freeze 1,035 million francs in a special account with the National Bank and thus to withdraw that amount from circulation.

In the light of the growing excess demand characterizing the economy, which was primarily due to too high a level of investment activity, the National Bank concluded in 1962 an agreement with the banks aimed at checking investment in buildings and plant from the lending side. Under this agreement the 350 institutions that were party to it undertook to keep their credit-granting within certain limits. In fixing the admissible rates of credit growth, the guiding aim was to obtain a slowing-down of credit expansion from the extremely high rates registered in 1960 and 1961 but to leave scope at the same time for meeting the urgent and economically justified credit needs of the private sector and the public authorities. Initially, permissible growth rates were fixed for the period April–December 1962. For 1963 these rates were reduced by 5 per cent; for domestic loans and advances, discounts, and advances to public corporations they stand at 82 per cent and for mortgage loans at 108 per cent of the increase in the items concerned in 1961 or 1960, whichever was the greater.

ANNEX
WEEKLY RETURN AND EXPLANATORY NOTE

SCHWEIZERISCHE

WEEKLY

as at December 31,

Assets		In thousands of francs
1. Gold stock		11,543,252
2. Foreign exchange		867,356
3. Domestic portfolio		
Bills of exchange	78,612	
Federal Treasury bills	45,000	
		123,612
4. Advances against collateral		71,738
5. Foreign Treasury bills in Swiss francs		207,000
6. Securities		
Eligible for note cover	16,180	
Others	26,656	
		42,836
7. Correspondents		
In Switzerland	77,754	
Abroad	10,205	
		87,959
8. Other assets		41,263
Total		12,985,017

NATIONALBANK

RETURN

1962

Liabilities		In thousands of francs
9. Own funds		54,000
10. Note circulation		8,506,072
11. Sight liabilities		
Giro balances of banks and commercial and industrial enterprises	2,294,235	
Other sight liabilities	505,432	
		2,799,666
12. Temporarily frozen giro balances of banks		1,035,000
13. Time liabilities		373,000
14. Other liabilities		217,279
Total		12,985,017

EXPLANATORY NOTE ON THE WEEKLY RETURN

ASSETS

1. GOLD STOCK

Under the terms of Article 19 of the Federal Law concerning the Swiss National Bank at least 40 per cent of the total note circulation must be backed by gold (coins or bars). This minimum cover must be kept in Switzerland. The totals of gold held inside and outside the country are not published separately. Any gold which may be held by the Confederation is not included in the National Bank's balance sheet.

In accordance with the Federal Currency Law of December 17, 1952, the franc equals 63/310 (= 0·20322 . . .) grammes of fine gold; one kilogramme of fine gold = 4,920 40/63 francs. Since May 31, 1940, gold has been shown in the balance sheet at the price of Fr. 4,869·80 per fine kilogramme, which is the purchase price for gold bars *loco* Berne.

2. FOREIGN EXCHANGE

The item 'Foreign exchange' comprises sight balances in U.S. dollars, and bills, cheques and easily realizable government bonds expressed in U.S. dollars, with maturities of up to three months. Bills and cheques must bear at least two independent signatures of known solvency.

3. DOMESTIC PORTFOLIO

Bills of exchange; Federal Treasury bills.

The item 'Bills of exchange' comprises Swiss bills and cheques bearing at least two independent signatures of known solvency. Cantonal and communal Treasury bills signed by a bank are included under this heading, which also covers discounted Swiss bonds and discounted Federal Debt Register claims. The discounted claims must not have more than three months to run.

Federal Treasury bills are debt certificates issued by the Confederation with maturities of up to three months. They may have been presented for discount either by the Confederation or by the market. This item also includes compulsory-stock bills. The National Bank co-operates in the financing of compulsory stocks held for the

purpose of safeguarding the country's supplies by discounting three-month promissory notes made out by holders of such stocks, which are guaranteed by Federal Treasury bills and can be renewed.

4. ADVANCES AGAINST COLLATERAL

The National Bank grants advances at interest on current account, for which not more than ten days' notice of withdrawal is required, secured by the pledging of Swiss bonds, Federal Debt Register claims or discountable bills. Gold in bars or gold coin is also accepted as security for advances. Advances may not be made against shares or participations in companies.

5. FOREIGN TREASURY BILLS IN SWISS FRANCS

These consist of short-term U.S. certificates of indebtedness in Swiss francs with more than three months to run. They can be redeemed at short notice at any time.

6. SECURITIES

Eligible for note cover; Others.

The securities eligible for note cover are the Treasury bills and bonds issued by the Confederation and the Federal Railways, Federal Debt Register claims, bonds issued by the cantons and the cantonal banks and mortgage bonds of the Swiss central mortgage institutions with not more than two years to run.

7. CORRESPONDENTS

In Switzerland; Abroad.

Correspondents are banks with which the National Bank regularly does business.

The National Bank's correspondents in Switzerland act as its local agents. They collect bills and cheques on its behalf and carry out payment transactions with its clients. In addition, they handle payment transactions (in-payments and out-payments) with the local offices of the Federal Administrations (the Postal Administration, the Federal Railways and the Customs Authorities).

Balances shown under the heading 'Correspondents abroad' represent balances held by the Swiss National Bank with foreign banks, in so far as these are not included in item 2 'Foreign exchange'.

8. OTHER ASSETS

This covers divisional coin, credit balances on postal cheque accounts, coupons, bills for collection, sundry debtors, fixed property, and current expenses.

LIABILITIES

9. OWN FUNDS

The Bank's own funds are composed of the paid-up share capital and the legal reserves. The share capital, which is divided into 100,000 registered shares of 500 francs, amounts to 50 million francs, half of which has been paid up. The Reserve Fund is increased by transfers from the net profits.

10. NOTE CIRCULATION

The counterpart of the note circulation must consist of gold, foreign exchange eligible as cover, discounts, secured advances or securities eligible as cover. Of the total note circulation reported at the end of 1962, 138 million francs represented notes withdrawn from circulation. The National Bank is bound to exchange withdrawn notes at their nominal value for a period of twenty years.

11. SIGHT LIABILITIES

Giro balances of banks and commercial and industrial enterprises; Other sight liabilities.

The item 'Giro balances of banks and commercial and industrial enterprises' consists of the credit balances of giro-account holders proper, who may keep interest-free deposits with the Bank. Up to June 23, 1961, the credit balances of foreign banks were included in this item.

The item 'Other sight liabilities' consists of balances held by the Federal Administrations and by depositors, and accounts connected with payments and clearing agreements concluded with foreign countries. Since June 30, 1961, it has included credit balances of foreign banks.

12. TEMPORARILY FROZEN GIRO BALANCES OF BANKS

These are balances which were transferred at the end of March 1961 from the giro accounts of banks to this special account in order to draw funds off the market.

13. TIME LIABILITIES

This item comprises the counterpart of Federal rescriptions which were placed with the banks on October 1, 1960, for the purpose of absorbing funds. The counterpart was not made available to the Confederation but was credited to a blocked account.

14. OTHER LIABILITIES

Among the 'Other liabilities' are included provisions for contingencies (the manufacture of bank-notes, monetary operations, uninsured loss or damage, taxes, alterations and repairs to the Bank's premises, etc.), undrawn dividends, outstanding cheques and miscellaneous profits.

SVERIGES RIKSBANK

I

ORIGINS AND LEGAL FRAMEWORK

Sveriges Riksbank was founded in 1668. The Bank has always been a state institution without any private interests. It has its Head Office in Stockholm and a branch office in each of the twenty-three provincial government towns. Its legal status as compared with that of other central banks is rather unusual in two respects. Firstly, the fundamental legal provisions are contained in the Constitution of Sweden. Secondly, the Riksbank is guaranteed and governed exclusively by the Swedish parliament, the Riksdag. It may be mentioned that another institution, the National Debt Office, occupies a similar position.

In the Swedish Constitution the provisions relating to the Bank are to be found in the first fundamental law of the Constitution,[1] the Instrument of Government, Articles 72 and 111:2, and in the Riksdag Act, Articles 41, 70:1 and 71. Within the framework of these constitutional provisions the legal status of the Bank is laid down mainly in the Riksbank Act of June 30, 1934 (SFS: 437),[2] as amended. The Riksbank Act, like other Swedish laws, was made jointly by the King in Council, i.e. the government, and the Riksdag. More detailed rules concerning the activities of the Bank are contained in the Bank Regulations of December 15, 1943, enacted by the Riksdag alone.

Another act of fundamental importance to the Bank is the Monetary Unit Act of May 30, 1873, which made gold the sole measure of value and introduced the krona with a weight of 0·403225 grammes of fine gold as the monetary unit.

By virtue of the provisions of the Riksbank Act concerning the right of issue, whereby the note issue was to be backed by the gold reserve and the secondary cover, and of the obligation imposed on

[1] The Constitution consists of four separate fundamental laws: the Instrument of Government, the Riksdag Act, the Act of Succession and the Freedom of the Press Act. The amendment or revocation of these fundamental laws requires two identical decisions of the Riksdag, the second decision being taken after general elections to the second chamber of the Riksdag. An English translation of the Constitution is to be found in documents published by the Royal Ministry for Foreign Affairs, New Series II: 4, Stockholm 1954.

[2] SFS is an abbreviation for Svensk Författningssamling (the official collection of laws and ordinances).

the Bank in the Instrument of Government to redeem notes in gold, the value of the notes was related to the value of gold. The redemption obligation had to be suspended during and after the First World War and again from September 28, 1931, onwards. The suspensions were based on an emergency clause in Article 72 of the Instrument of Government. The regulations governing the note cover and the note issue contained in the Riksbank Act had also to be suspended at the beginning of the Second World War under temporary legislation which has not yet been replaced (see page 315).

The Riksbank has also obtained important powers from certain emergency laws. One of these is the Foreign Exchange Law, which was introduced in its first version on June 22, 1939 (SFS: 350). Pursuant to this law further provisions were made in the Foreign Exchange Ordinance of February 25, 1940 (SFS: 125). The most important amendments to the Foreign Exchange Law date from 1957 (SFS: 251) and 1959 (SFS: 262).

An enabling Act with Special Regulations on the Cash Reserves of the Commercial Banks was introduced in 1937 (SFS: 305). It was amended several times in subsequent years but was applied only from the autumn of 1950 to February 1952. An emergency Law regarding the Regulation of Interest Rates on Credits was promulgated in 1951 (SFS: 767). It was never applied. From July 1, 1962, these two laws were replaced by three new enabling laws: the Law concerning Liquidity Ratios and Cash Ratios for certain credit institutions (SFS: 256), the Law concerning Investment Ratios for certain credit institutions (SFS: 257), and the Law concerning Control of Rates of Interest and Bond Issues (SFS: 258).

The legislation concerning the Riksbank is characterized by an endeavour to draw a clear line of demarcation between the government on the one hand and the Riksdag and its institutions on the other.

The capital of the Riksbank amounts to 50 million kronor; in addition, there is a general reserve fund of 20 million kronor. In so far as the reserve fund falls below this amount, 10 per cent of the annual profits of the Bank has to be paid into the fund. Subject to this restriction, the Riksbank's profits are at the disposal of the Riksdag. Generally, part of the profits are appropriated to an exchange adjustment account; the remainder goes into the state budget.

If negotiations between the government and the Riksbank are considered necessary, the government may appoint delegates to negotiate with the Board of Directors of the Bank, but the Board may not make any decisions in the presence of these delegates.

The Bank's activities are supervised and controlled on behalf of the Riksdag primarily by one of its standing committees, the Banking Committee. The auditors of the Riksdag, who are appointed at each

session by the Riksdag with authority to examine the public administration as a whole, also have special tasks connected with the investigation of the Bank's business.

The Board of Directors is responsible to the Riksdag alone, and the Bank's policy is thus formally independent of the government. It must be remembered, however, that the strict formal division of responsibility as between the government and the Riksbank originated in a period when the government was to a large extent independent of the Riksdag and when, furthermore, the ambitions of the state in the field of economic policy were very modest. In present conditions, with vastly increased responsibilities of the state and with a parliamentary form of government, the general economic policy of the government and the monetary policy of the Riksbank are, of course, closely co-ordinated.

II

FUNCTIONS AND OBJECTIVES

It will be clear from what has been said that the legislation concerning the Riksbank has not been codified in an up-to-date law on central banking but is to be found in a number of different laws and regulations which have often been modified. The core of this legislation has its origin in the era of the gold standard when the aims of central banking were regarded as self-evident and when, consequently, there was no urgent need to state them explicitly.

This applies, for instance, to the objective of safeguarding monetary stability. In the late 1890s, in which the Riksbank Act of 1934 has its origins, this problem was considered solved by the gold standard. Nor is the competence of the Riksbank as the policy-making institution in the monetary field explicitly laid down in the Riksbank Act. It is also significant that the most clearly regulated activity of the Riksbank should be the issue of notes, once considered the key element in monetary policy but today generally regarded as a by-product of economic developments.

Although the present objectives of the Riksbank are not specified by law, they may be summarized as follows:

(i) to decide on and carry out a monetary and credit policy within the framework of the general economic policy determined by the Riksdag;
(ii) to facilitate payments by issuing notes and by acting as the lender of last resort to the banks and as a clearing house for interbank payments;

(iii) to administer the country's official reserves of gold and foreign exchange;
(iv) to act as banker to the government.

III

STRUCTURE AND ADMINISTRATION

The main decision-making bodies of the Bank are the Board of Directors and the Board of Management; these will be dealt with first. Then follows a description of the supervision and control by the Riksdag, which is carried out mainly through the Banking Committee. Lastly, an overall survey will be given of the organization of the Head Office and the branch offices.

BOARD OF DIRECTORS

The Bank is governed by a board of seven directors. Before 1897 all of them were elected by the Riksdag. The Riksbank Act of 1897, however, authorized the government to appoint the Chairman and an alternate. This arrangement was essentially intended as a counterweight to the influence of short-sighted political opinions in the Riksdag but did not aim at changing the status of the Bank as an institution of the Riksdag. The Chairman and his alternate may not hold any other office in the Bank. They are appointed for three years, but their terms of office can be brought to an end at any time by the government.

The other six directors and six alternates are chosen by forty-eight electors of the Riksdag, twenty-four from each chamber. They serve for periods of three years and are eligible for immediate re-election. In order to ensure the continuity of the Board the elections are so arranged that the terms of office of two of the directors elected by the Riksdag expire each year.

The Board appoints the Governor and the Deputy Governor; the former must be chosen from among the directors elected by the Riksdag. When the Chairman is unable to preside at a meeting the alternate appointed by the government joins the Board as a member but the chair is taken by the Deputy Chairman, who is elected by the directors from among themselves. One director serves permanently on the Board of Management and he has regularly been elected Deputy Chairman.

The Board of Directors may not accept instructions from anyone but the Riksdag, or its Banking Committee in those cases where the

Committee has been given authority to act on behalf of the Riksdag. In its administration of the Bank the Board is responsible only to the Riksdag.

The Board must meet at least once a fortnight; in practice, however, it usually meets each week. At least five directors must be present at the meetings. Urgent matters, however, may be settled by only four directors if three of them are in agreement. If the voting is even, the Chairman has the casting vote. Any director present who has not stated his opinion is considered to have agreed with the decision of the majority.

The Deputy Governor and the managers of the Bank should be present at meetings of the Board.

BOARD OF MANAGEMENT, ETC.

The Board of Management of the Riksbank consists of the Governor, the Deputy Governor, the director permanently on the Board of Management, one of the other directors elected by the Riksdag (director in charge by rotation) and the reporting manager.

The powers and duties of the Board of Management are defined in an instruction issued by the Board of Directors. According to this instruction the Board of Management shall

(i) prepare the questions to be dealt with by the Board of Directors;
(ii) execute the decisions taken by the Board of Directors;
(iii) supervise the internal administration of the Bank;
(iv) buy and sell foreign exchange except in cases where the Governor or one of the managers is authorized by the Board of Directors to carry out such transactions;
(v) grant loans and other credits in accordance with the intentions expressed by the Board of Directors;
(vi) deal with other questions of a routine character.

The instruction emphasizes the duty of the Board of Management to follow developments on the credit and foreign exchange markets and to keep the Board of Directors informed on these matters. The Board of Management is also charged with the task of keeping the Bank's internal organization up to date and—under the Board of Directors—of supervising the Bank's staff.

Some matters fall outside the competence of the Board of Management and there are, consequently, other bodies immediately responsible to the Board of Directors. The Riksbank owns a paper-mill and a note-printing works, which are administered by a separate Industrial

Board. Foreign exchange control is also, under special legislation (see page 319), administered by an Exchange Control Board. Lastly it may be mentioned that the Auditing Department is not subordinated to the Board of Management.

CONTROL BY THE RIKSDAG

The Banking Committee is one of the standing committees of the Riksdag elected at the beginning of each year. It consists of sixteen members. In January each year the Board of Directors reports to the Committee on the activities and the administration of the Bank during the preceding year, and the Committee immediately forwards the report to the Riksdag. Later during the spring session the Banking Committee presents its observations to the Riksdag and suggests that the report should be adopted or rejected. The question is then debated in the Riksdag, which finally decides whether the administration of the Bank should be approved or not. In practice, the right to reject the report has never been exercised, but the debate offers an opportunity for discussing the policy of the Bank. The observations made in this connection by the Banking Committee are sometimes extended to form a review of economic conditions, credit policy and economic policy in general. Often, however, this review is postponed to the end of the spring session, when the Committee produces a report on the fixing of the maximum amount of the note circulation for the next financial year (see page 316).

The Committee also makes proposals as to how the Riksdag should dispose of the Bank's profits. The Committee's proposals have regularly followed the suggestions of the Board of Directors of the Bank.

In matters concerning only the application of regulations made earlier by the Riksdag the Committee may act with the same authority as the Riksdag.

At the beginning of its spring session the Riksdag elects twelve auditors, six from each chamber. The auditors are required, in addition to many other duties, to examine the management and administration of the Bank. These auditors should not be confused with the Auditing Department of the Bank, with which they have no connection.

The Riksbank is thus subject to a double control by the Riksdag, both through its Banking Committee and through its auditors. In practice, however, the Banking Committee is the main controlling body, not only in matters connected with monetary policy but also in other fields, such as the internal administration of the Bank and of its industrial undertakings.

ORGANIZATION OF THE HEAD OFFICE

The organizational structure of the Head Office has frequently been adapted to changes in the relative importance of the different activities of the Riksbank.

For the last few years the Head Office has contained ten departments, of which the following nine are under the control of four Managers:

(1) Legal Department
Administrative Department
Banking Department
Central Agency of Branches
(2) Credit Market Department
Securities Department
(3) Foreign Department
(4) Department for Relations with International Organizations
Exchange Control Department.

The tenth department, the Auditing Department, is directly responsible to the Board of Directors.

BRANCH OFFICES

The main business of the Riksbank's branch offices nowadays is to distribute notes and coin, their lending to commerce and industry having become insignificant. The branch offices have, however, received some compensation for the loss of their former commercial banking business by being entrusted with the administration of loans from special funds, e.g. home-furnishing loans, support loans to farmers and loans to students.

For each branch office the Board of Directors appoints a Managing Board, consisting of the branch manager plus three or four other persons. The latter are so chosen as to ensure that the Board has a comprehensive knowledge of economic and social conditions in its district. The autonomy of the branch offices is limited. They have to send reports daily to the Head Office and they must refer to it all matters of primary importance.

PUBLICATIONS

The Riksbank is required to publish a monthly survey of accounts showing its principal assets and liabilities and a weekly statement of the gold reserve, the other assets which together form the secondary note cover, the notes in circulation and the unexercised right of issue. The weekly statements and the monthly surveys were earlier published as two independent series but in 1946 the content of the weekly statement was enlarged to conform with the monthly survey.

Since 1908 the Riksbank has published a yearbook containing, *inter alia*, a survey of developments on the credit market and detailed statistics on the activities of the Riksbank and the commercial banks as well as on the capital and foreign exchange markets. There is also an English translation of the yearbook, which since 1961 has been published separately.

IV

POWERS AND ACTIVITIES

NOTE ISSUE

By virtue of the Riksbank Act of 1897 the Riksbank became the sole bank of issue, and in the same year the notes of the Bank were made unlimited legal tender. The Bank issues notes of Kr. 5, 10, 50, 100, 1,000 and 10,000.

The Riksbank Act of 1934 fixed the maximum amount of the note issue at a figure equivalent to twice that of the gold reserve plus Kr. 350 million. In an emergency, however, the government can, at the request of the Board of Directors, authorize the Bank to issue an additional amount of not more than Kr. 350 million ('the emergency amount'). The Riksbank Act also stipulates that the portion of the notes in circulation exceeding the gold reserve shall be covered by the following assets (secondary cover):

(i) easily marketable government securities;
(ii) bonds of the General Mortgage Bank of Sweden (Sveriges Allmänna Hypoteksbank) and of the City Mortgage Bank of the Kingdom of Sweden (Konungariket Sveriges Stadshypotekskassa) as well as other Swedish bonds quoted on foreign stock exchanges;
(iii) such gold coin and bullion deposited abroad or in transit, duly insured, as is not included in the gold reserve;
(iv) bills of exchange payable within the country or abroad;
(v) deposits with banks or bankers abroad falling due within six months, less any sums owing by the Riksbank to banks or bankers abroad;
(vi) advances at not more than three months' notice made against government securities and bonds of the types mentioned above as well as, up to an amount not exceeding Kr. 100 million, against other security.

These provisions were in operation until the end of 1939, when a temporary law was passed by virtue of which the emergency amount of Kr. 350 million was gradually increased to Kr. 2,500 million.

In 1948, in order, *inter alia*, to restore the influence of the Riksdag

in the matter of the note issue, a new temporary law was adopted which has since been prolonged on a yearly basis. According to this law the note issue must not exceed a fixed amount, which has gradually been raised from Kr. 3,200 million to the present figure of Kr. 7,800 million. There is an additional emergency amount of Kr. 700 million. The rule that the notes issued must be covered by gold or secondary cover assets has been in operation all the time.

BANKING BUSINESS—THE PROVISIONS OF THE RIKSBANK ACT

The Riksbank Act of 1934 states that the Bank may not carry out any transactions other than those explicitly permitted by, and listed in, the Act. The essential items in this list may be divided into three groups, namely those connected with the foreign exchange market, those related to the Swedish credit market and those that derive from the Riksbank's position as banker to the government.

The provisions relating to foreign exchange transactions allow the Bank to take up credits abroad and to grant credits to foreign central banks. The Bank may also deposit funds with banks abroad and may accept interest-bearing or non-interest-bearing deposits from them. The Bank may buy and sell

(i) gold and silver;
(ii) foreign exchange up to one year forward;
(iii) easily marketable foreign government bonds and other government securities;
(iv) other easily marketable foreign bonds, provided that they fall due within one year.

The Bank may further acquire shares in the Bank for International Settlements up to an amount determined by the King in Council and the Riksdag.[1]

The major part of the provisions regarding the operations of the Riksbank deal with its activities on the Swedish credit market.

The Bank may buy and sell Swedish Government bonds, other Swedish Government securities and other Swedish bonds.

Moreover, in its capacity as a lender the Bank may

(i) discount bills falling due within six months;
(ii) make advances on bonds, shares or other securities for a fixed period not exceeding six months or at not more than three months' notice (municipalities and similar public bodies may, however, obtain advances without collateral, subject to the conditions of payment stated above);

[1] In accordance with a decision of the Riksdag of May 7, 1930, and a royal ordinance of May 9, 1930, the Riksbank may acquire such shares up to a nominal amount of 20 million Swiss (gold) francs.

(iii) make advances redeemable at a fixed date within six months against the pledging of merchandise deposited in certain specified forms;

(iv) open credits on current account, for a period not exceeding twelve months, against bonds issued by the Swedish State, the General Mortgage Bank of Sweden or the City Mortgage Bank of the Kingdom of Sweden or, up to an amount of Kr. 15 million, against other security;

(v) grant loans from special funds placed under the administration of the Riksbank.

The Riksbank may accept deposits

(i) on cheque account, without interest, repayable on demand;

(ii) on deposit account, without interest, repayable on demand or at a date fixed when the deposit is made. Receipts for such deposits must be issued in a specific name.

The Board of Directors of the Riksbank may, however, allow firms which discount bills with the Riksbank and do not themselves carry on banking business to receive interest on funds deposited on cheque account. Where circumstances call for it, the Board of Directors of the Riksbank may also allow interest to be paid on deposits in other cases.

As banker to the government the Riksbank accepts deposits without interest from the Treasury and makes payments from the Treasury's credit balance in accordance with special regulations.

The Riksbank is also obliged to accept for custody in open deposit at the Head Office securities lodged for that purpose by state authorities or deposited with the Riksbank in accordance with special regulations.

There are in the Riksbank Act no regulations concerning the granting of direct credits to the government.

BANKING BUSINESS IN PRACTICE

The provisions of the Riksbank Act summarized above do not give a very clear picture of the different kinds of banking operations carried out by the Bank or of their relative order of importance. They have much the appearance of a rather old-fashioned set of regulations for ordinary commercial banking business. However, the operations of the Riksbank have since the end of the last century been gravitating towards central-banking activities proper, while its commercial banking operations have simultaneously been decreasing. This development, which is now complete, has resulted partly from the growth of various types of private credit institutions and partly from a deliberate endeavour by the Riksbank to create a rational

division between its activities and those of other credit institutions, particularly commercial banks. In this connection it may be mentioned that there exists in Sweden a government-owned commercial bank whose customers include the government business enterprises. It has no special connections with the Riksbank.

On the foreign side the Bank is responsible for the management of the central reserve of gold and foreign exchange, which appears as an asset item in the Bank's balance sheet. Transactions in foreign exchange are, of course, carried out abroad with foreign banks and in other forms. Within the country the Bank's foreign exchange dealings are restricted to transactions with the commercial banks, which themselves keep foreign exchange to a varying extent; some keep only working balances, while others may have substantial holdings. This part of the Bank's business is the responsibility of the Foreign Department.

The Bank's domestic business is also of a central-banking type. It comprises sales and purchases of bonds and Treasury bills and the granting of short-term advances to banks against the collateral of Treasury bills or bonds, a form of transaction which has completely replaced rediscounting as the instrument for giving temporary support to the banks. Transactions in securities and lending to banks are carried out through the Securities Department. More will be said about these activities in the section on credit policy.

The distribution of notes is handled locally through the branch offices and centrally by the Banking Department. This department is also responsible for the deposit accounts kept, almost wholly, by government institutions and commercial banks, and also for the interbank clearing operated by the Riksbank.

As the government's banker the Riksbank receives deposits from the central government and the National Debt Office. The Bank is not, however, the banking agency of government enterprises or of local authorities. Its traditional position as the government's banker also explains why the Bank administers a series of special loan funds. These funds are provided from the government budget and are, with one exception, not included in the Riksbank's balance sheet. There are also some special deposit accounts created under tax laws, which at present make up the bulk of deposits on accounts other than cheque accounts. It has been a condition of special tax concessions to enterprises that funds should be deposited with the Riksbank.

FOREIGN EXCHANGE CONTROL

When foreign exchange control was being prepared in 1939, one question which arose was that of the co-ordination of the powers of the government and those of the Riksbank. Such co-ordination was

realized, in principle, in the Foreign Exchange Law of December 22, 1939. This was an emergency law authorizing the government, in war, danger of war or extraordinary conditions caused by war, to introduce centralized control over all payments to and from foreign countries, if this became necessary for reasons of monetary policy. It was the task of the Riksbank to administer this control. Two prerequisites had, however, to be fulfilled. Firstly, the Board of Directors of the Riksbank had to have called for such control, and, secondly, the Riksdag had to have given its consent or confirmation. The law was valid for one year only but was prolonged annually.

Based on the Foreign Exchange Law and with the consent of the Riksdag, a Foreign Exchange Ordinance was issued on February 25, 1940, giving more detailed provisions for the control. This ordinance has been repeatedly amended but its fundamental points have remained unchanged.

By an amendment of the Foreign Exchange Law in 1957 the former Foreign Exchange Control Office was reorganized as a special Exchange Control Department at the Head Office of the Riksbank. Exchange control matters are decided by the Exchange Control Board, which consists of seven members. Four are appointed by the government and three by the Board of Directors of the Riksbank. Appeals against the decisions of the Exchange Control Board are dealt with by the Board of Directors of the Riksbank.

Since the war several emergency laws have been generally revised and transformed into permanent laws. Such was the case with the Foreign Exchange Law in 1959. In its present form the law distinguishes between three situations in which exchange control may be applied:

(i) If Sweden becomes involved in a war some of the most important articles of the Foreign Exchange Law are automatically put into force.
(ii) If there is a danger of war the government (after consulting the Board of Directors of the Riksbank) may proclaim a similar control, which, however, has to be confirmed by the Riksdag.
(iii) In situations other than those of war or danger of war the government may, with the consent of the Riksdag and upon the request of the Board of Directors of the Riksbank, put the same articles into force for not more than one year, if this is necessary either to achieve the aims of the Riksbank's monetary policy or because of Sweden's foreign payments situation.

It is thus only the basic Foreign Exchange Law which is permanent, whereas actual foreign exchange control is applied temporarily.

This legislation may be described as an attempt to combine the wider powers needed by the state in the above situations with the strongest possible guarantees against their being abused.

Since the war foreign exchange control has been gradually eased. At present it applies almost exclusively to capital transfers. Practically every other kind of transaction may be performed on a commercial bank's own responsibility under general authorizations.

INTERNATIONAL ORGANIZATIONS, PAYMENTS AGREEMENTS, RESEARCH

The Riksbank takes an active part in the preparation, negotiation and administration of bilateral payments agreements. This work, which is, of course, now diminishing in volume, is carried out by the Department for Relations with International Organizations. The Bank also acts as depositary for and channel of communication with the International Monetary Fund and the International Bank for Reconstruction and Development and as the national expert authority on certain international financial questions arising particularly in the Organisation for Economic Co-operation and Development.

The Department for Relations with International Organizations, the Exchange Control Department and the Foreign Department each carry out statistical and research work directly connected with their own main activities, but general research is mostly done in the Credit Market Department. The work of the latter department, comprising both current statistical information and special inquiries, is mostly confined to the credit market and factors immediately connected with it; the general course of economic developments in Sweden and abroad is also followed, however, in co-operation with government research agencies, particularly the Economic Section of the Ministry of Finance and the Economic Research Institute.

V

MONETARY POLICY

CREDIT POLICY AS AN INTEGRAL PART OF ECONOMIC POLICY

In Section I attention was drawn to the independent legal position of the Riksbank *vis-à-vis* the government, but it was also emphasized that the economic policy of the government and the credit policy of the Riksbank need to be co-ordinated.

It must, firstly, be stressed that broad political co-ordination between the government and the Board of Directors of the Riksbank

is established by the fact that the composition of both the government and the Board is an outcome of the same political situation. The government is normally formed by a party or coalition commanding a majority in the Riksdag; in any case its policy must be acceptable to the Riksdag. The directors of the Bank are chosen from among the members of the Riksdag in such a way that the Board reflects the relative strength of the political parties in the Riksdag. Co-ordination is also strengthened by the government's right to appoint the Chairman of the Board. An exception to the rule of choosing members of the Riksdag as directors is the choice of Governor; the Governors have been drawn from the public administration—including the Riksbank—or from private enterprise.

Secondly, in various ways the Riksdag lays down the aims to be pursued by economic policy. For instance, every January together with the budget proposals it receives a financial survey explaining the government's view of the economic situation and of the measures that it calls for. In a general way, the Riksdag's acceptance or rejection of the main budget proposals indicates its view of what the goals of economic policy should be. More explicit opinions are given in committee reports on major measures of economic policy, and also, as mentioned earlier, in some reports of the Banking Committee; by its decisions the Riksdag generally puts its authority behind the majority opinion expressed in these reports. It should be stressed that the Board of Directors receives only very general guidance in this form. The co-ordination through the Riksdag does, however, probably exclude major divergencies between the aims of fiscal and credit policy.

The arrangement envisaged in the Riksbank Act for consultation between the Board of Directors and representatives of the government (see page 309) has been used only occasionally, the last time having been in 1947. Less formally there are frequent contacts at all levels—from the Governor downwards—between officials of the Bank and government departments. Collaboration is, of course, especially close with the Ministry of Finance, the National Debt Office and, on the foreign side, with the Ministry of Foreign Affairs and the Ministry of Trade. These contacts do much to ensure co-ordination of fiscal policy, debt management and credit policy.

Lastly, it may be mentioned that it is a long-established practice in connection with important proposals, such as, for example, those made by Special Committees, to ascertain the opinion of the public and private institutions involved before a bill is presented to the Riksdag. These opinions are made public and are often referred to at later stages. This procedure gives the Riksbank a wider opportunity to influence economic policy.

INSTRUMENTS OF CREDIT POLICY

The credit-policy instruments at the Bank's disposal can be summarized as follows:

(1) Discount policy
(2) Open-market operations
(3) Reserve requirements
(4) Recommendations to credit institutions on their investment pattern
(5) Control of bond issues.

DISCOUNT POLICY

The discount rate of the Riksbank is of fundamental importance for the whole structure of interest rates. Even in periods when the commercial banks do not need to borrow from the Riksbank, a change in the discount rate is interpreted as a signal for corresponding changes in the commercial banks' rates for loans and deposits and also in the rates of the savings banks and agricultural credit banks. The connection is not, however, very rigid in the case of bank lending rates, the structure and level of which can change independently of changes in the discount rate. On some occasions readjustments were also made in the relations between the banks' deposit rates and the Riksbank's discount rate.

At present the Riksbank publishes only one discount rate, the 'official rate'. Until 1950 a rediscount rate, regularly ½ per cent below the official rate, was applied to rediscounting by the commercial banks. From the beginning of October 1950 to the beginning of June 1952 there was no special rediscount rate for the commercial banks, which borrowed at the official rate. In June 1952 the Riksbank stated that the rediscount rate would not be tied to the official rate but varied and adapted to the actual situation in the market.

The discount rate retains its conventional importance in the rate structure but bank borrowing from the Riksbank during the postwar period has changed its form from rediscounting of trade bills to short loans with Treasury bills or bonds as collateral. The rate of interest on these advances, which run for a minimum period of three days, has during the last few years been equal to the discount rate for the first five days and 1 per cent above the discount rate from the sixth day; in order to be able to borrow anew at discount rate a bank must have been free from debt to the Riksbank for at least three days. During the 1950s bank liquidity was high and the banks had recourse to the Riksbank for very short periods only, mostly at the end of the month. In 1960, however,

Riksbank lending to the banks was much larger in amount and longer in duration.

In the spring of 1961 there were indications that the effect of the liquidity squeeze might be jeopardized by the fact that banks would come to regard borrowing at the Riksbank as a normal source of finance. The Riksbank then introduced a penalty rate of 9 per cent, applicable to that part of a bank's borrowing which exceeded one-half of its own funds. Although the penalty rate was charged only in a few cases for brief periods, it seems to have had a considerable restraining effect on the lending policies of the banks. The penalty rate was abolished in January 1962 when there was no longer any need for monetary restriction.

The changes in the official discount rate between 1945 and 1960 and an indication of the corresponding changes in the deposit and loan rates of the banks are given in the following table.

Official discount rate		Advertised rates of commercial banks		
As from	Rate	Typical deposit rate*	Lowest discount rate†	Typical loan rate‡
February 9, 1945 .	2½	2 2½ (1949)	2½	4
December 1, 1950 .	3	3	3	4½
November 20, 1953	2¾	3	2¾ 3¼ (1954)	4½
April 19, 1955 .	3¾	4	4¼	5½
November 23, 1956	4	4¼	4½	5¾
July 11, 1957 . .	5	5	5¾	6¾
May 3, 1958 . .	4½	4½	5¼	6¼
January 15, 1960 .	5	4¾	5¾	6¾
April 6, 1962 .	4½	4¼	5¼	6¼
June 8, 1962 . .	4	3¾	4¾	5¾
January 18, 1963 .	3½	3¼	4¼	5¼

* Long-term deposit account (since 1949 six months' notice).
† Discount rate for three-month bills (a rather nominal advertised rate).
‡ Three-month loans against 'other security'.

The gradual abandonment of the low-interest policy is reflected in the upward trend in the adjustments during the period 1950–57.

In the last few years the discount rate changes have been a normal part of anti-cyclical economic policy. The deposit rates advertised by the banks have followed the discount rate closely but with some tendency towards a widening of the gap between deposit and lending rates.

OPEN-MARKET OPERATIONS

During the inter-war period the Riksbank had, like many other European central banks, strong inhibitions against buying or selling securities in the market with a view to influencing interest rates or the liquidity of the banks. In the 1940s its attitude changed and the Riksbank entered the market in order to support the low rates on long bonds established during the war, a policy which at times led to extensive purchases. During the 1950s the rigid cheap-money policy was gradually abandoned and consequently one impediment to efficient liquidity control through open-market operations was removed.

Another problem facing the Bank has been the growth of government borrowing. This development has many aspects, but the point to be made here is that the borrowing needs of the state have led to, one might say have forced, an amalgamation of debt management and open-market operations. In institutional terms this means close co-operation between the Riksbank and the National Debt Office. The timing and terms of government bond issues are the outcome of discussions between the Bank and the Office. In comparison with the government's issues the Bank's operations in the bond market have for some years been small and not very frequent. Its holdings of bonds of various types and maturities are relatively very large, however, and in a changed situation the Bank would not be hampered in carrying out large sales or switches by lack of material.

A third problem in this connection has been the absence of a money market which could be used as a channel of intervention. Up to the Second World War the government debt consisted almost wholly of long-term bonds held by insurance companies, pension and other funds, savings banks and private investors and also by commercial banks. The market for long bonds may have been thin, but markets for short bonds and shorter paper were non-existent. During the war Treasury bill financing became important and issues of short bonds started on a significant scale in 1952. Short bonds and Treasury bills have, however, been taken up almost exclusively by commercial banks; they have generally been held to maturity by the original buyer and bought only to an extent that was calculated not to endanger his cash position. A real money market with more flexible

FACTORS AFFECTING THE LIQUID ASSETS OF THE COMMERCIAL BANKS, 1958–60[1]

Items	Twelve-month period ending November[2]		
	1958	1959	1960
	In millions of kronor		
AFFECTING FACTORS			
Gold and foreign exchange holdings	+ 175	+ 330	— 438
Government deficit	+ 703	+1,352	+1,067
Government borrowing outside the Riksbank and the commercial banks (increase —)	— 267	— 101	—1,169
Note circulation outside the commercial banks (increase —)	— 93	— 135	— 367
Investment fund deposits at the Riksbank (increase—)	— 74	— 29	— 915
Other Riksbank transactions	— 107	— 50	— 163
Commercial banks' purchases of mortgage institutions' bonds (net nominal value)	+ 266	+ 367	+ 118
Other transactions of commercial banks	— 31	— 12	+ 260
Total	+ 572	+1,722	—1,607
COMMERCIAL BANKS' LIQUID ASSETS			
Cash and domestic cheques	— 10	+ 74	+ 87
Swedish banks (net claims)	+ 19	— 341	+ 101
Foreign banks and bankers (at sight, net claims), foreign bills	+ 90	+ 485	— 632
Treasury bills	— 298	— 162	— 710
Government and mortgage institutions' bonds (nominal value)	+ 771	+1,666	— 453
Total	+ 572	+1,722	—1,607

[1] A minus sign indicates a decrease in the commercial banks' liquid assets and a plus sign an increase.

[2] At the end of 1959 large-scale temporary liquidity movements occurred in connection with the introduction, as from the beginning of 1960, of a general sales tax. To avoid confusion the figures refer to the twelve-month period ending November each year.

rates had, however, existed for a long time in the form of overnight loans between commercial banks and some other institutions.

The last few years—say from 1957 onwards—have been marked by attempts to cultivate the money market and to use intervention there as an instrument of credit policy. The rates on short-term issues and Treasury bills have been made more flexible and generally higher, thus increasing their attractiveness as bank investments. Attempts have also been made to place short bonds and Treasury bills with non-bank investors. The outcome seems at least to make further efforts in this direction worth while, despite the fact that the high rates offered by banks on time deposits make progress slow and uncertain. In addition, the National Debt Office has started borrowing in the market for overnight or very short loans.

A point of some interest is that the more active policy pursued in the capital and money markets has taken the form of government borrowing operations carried out by the National Debt Office rather than of Riksbank operations. This has been a natural consequence of the level of government borrowing. It should be stressed, however, that the development in the short markets has appreciably widened the Riksbank's field of action. The discount rate has acquired a new significance as a determinant of the maximum rate paid for overnight loans. As the marginal lender to the National Debt Office the Bank influences the terms on which the Office is prepared to borrow from banks and the public against Treasury bills or in the form of overnight loans. It is also open to the Bank to intervene directly in the money market, e.g. by selling Treasury bills under repurchase agreements. If the Bank wanted to create more liquidity, and in the absence of current government borrowing could not do so by buying Treasury bills directly from the National Debt Office, it could make fairly large purchases of Treasury bills and short bonds in the market.

A good illustration of debt-management policy is provided by developments between 1958 and 1960, when the aim shifted from expansion to restriction (see the table on the preceding page).

During 1958 and 1959 the greater part of government borrowing was localized in the banking system. Attempts were made, however, to encourage banks to place the increase in their liquid assets in short bonds rather than in Treasury bills and overnight or other short loans. To some extent this policy met with success, but there occurred also during 1959 a large increase in the banks' easily mobilizable foreign exchange holdings.

In 1960 large-scale operations were carried out, the object of which was to reduce the liquid assets of the banks and exert pressure on their liquidity and cash positions. Government borrowing in the market outside the banks increased. In a large funding operation

Kr. 1,100 million's worth of long bonds was sold in March. The deposits at the Riksbank under the investment fund scheme (an amount of Kr. 900 million) had the same effect on the credit market as a short-term loan taken up by non-financial firms. Some Kr. 150 million's worth of short bonds and Treasury bills was sold to firms and private investors and the same amount was brought in by a savings bond loan in November.

As a result of these operations and other factors shown in the table the liquid assets of the banks declined by Kr. 1,600 million. The largest decreases were in the foreign exchange and Treasury bill holdings.

RESERVE REQUIREMENTS FOR COMMERCIAL BANKS

Reserve requirements as an instrument of credit policy were introduced in an enabling Act of 1937. The basic banking legislation of 1911 contained, it is true, as does the Banking Act of 1955, some liquidity rules, but these were aimed at protecting the depositors and could not well be used for credit-policy purposes.

The Act of 1937 was prolonged for one year at a time, and major amendments were made in 1939 and 1949. It empowered the government, at the request of the Board of Directors of the Riksbank and after obtaining the opinion of the Bank Inspection Board, to prescribe by ordinance minimum cash ratios and minimum liquidity ratios for commercial banks. The law was last prolonged to June 30, 1962, when it was replaced by a new law (see page 330).

Only one ordinance, which ran from October 1, 1950, to February 7, 1952, was issued under the law. The reason for its revocation on the latter date was that an agreement had been reached between the Riksbank and the commercial banks whereby the latter undertook to observe certain liquidity ratios. The ratios fixed in 1952 remained unchanged until July 1959 and the methods of calculation are still the same as they were in 1952. In 1954 there occurred a change, in that the agreement was replaced by a recommendation.

The ratios are those in which total liquid assets must stand to total liabilities and they are expressed as percentages. For the calculation of the 1952 ratios liquid assets are considered, broadly speaking, to comprise cash holdings, net claims on Swedish banks, net foreign sight assets, government securities and bonds of the General Mortgage Bank, the City Mortgage Bank and the Residential Credit Bank. Bonds are included in the calculation at their nominal value. Liabilities consist principally of deposit accounts, including bank drafts and acceptances but excluding savings deposits.

For the fixing of the ratios the banks were in 1952 divided into five groups. The minimum ratios were fixed for the various groups at 33, 29, 25, 20 and 15 per cent respectively. The actual ratios were calculated at the end of each month. The above-mentioned figures

corresponded to an average ratio for all the banks of about 30 per cent—a higher level than the average of the actual ratios, which at the end of 1951 was about 27·5 per cent. The differences between the various banks were also very large: for instance, at the end of 1951 only five of the seventeen banks had ratios above the levels fixed in February 1952. Thus during a transitional period, i.e. so long as the ratios laid down had not been attained, the agreement had in practice the effect of making it necessary for additions to deposits to be used principally for increasing liquidity. The agreement was followed by a decline in bank lending and a rise in the actual liquidity ratios. In conjunction with this there also took place a notable levelling-out of the variations in liquidity positions between different banks.

In July 1959 the recommendation concerning liquidity ratios was revised in order to adjust the ratios required to the actual liquidity situation and to provide the basis for an active application of the liquidity-ratio system as an instrument of credit policy. This did not entail any change in the definition of the ratios or in the methods of calculating them. For the purpose of fixing the ratios the banks were divided into three instead of the previous five groups. The ratios fixed in July 1959 were 40, 30 and 20 per cent. At the end of that month only three banks had ratios more than a few percentage points below the new requirements. In January 1960 the recommended liquidity ratios were raised to 45, 35 and 25 per cent respectively for the end of February 1960, and from then on they were to be 43, 33 and 23 per cent until further notice. When the investment boom was subsiding in the autumn of 1961, the first two ratios were lowered to 30 and 25 per cent respectively and the third group of banks was merged with the second. The new ratios gave the banks a comfortable margin of free liquidity and were consistent with a rapid expansion of bank advances. The ratios are, furthermore, probably rather close to the level which the banks now consider normal.

Since their introduction the liquidity ratios have not been used very actively to influence the expansion of bank credit. During the credit squeeze of 1955–57 the main instrument used was a direct ceiling on lending, and in 1960 and 1961 open-market operations (in a wide sense, including government financing operations) assumed a leading rôle. But the ratios have played their part as a stabilizing element limiting the credit potential of the banks.

RECOMMENDATIONS TO CREDIT INSTITUTIONS ON THEIR INVESTMENT PATTERN

In connection with the arrangements made in 1952 regarding liquidity ratios the Riksbank also concluded agreements with the

savings banks, the agricultural credit system, the insurance companies, the General Mortgage Bank, the City Mortgage Bank and the Residential Credit Bank concerning a more restrictive lending policy. These agreements did not contain any precise rules regarding the investment of funds, but the undertaking entered into by the insurance companies was framed in such a way as to prevent the credit restrictions from bringing about any structural shift in the pattern of their lending.

In later years some of these agreements were terminated, while others were made more specific and converted into recommendations. In 1960–62 recommendations regarding their asset distribution applied to insurance companies, savings banks and provincial agricultural credit associations. The recommendations to the insurance companies and the savings banks aimed at furnishing the central government and housing sectors with various forms of credit in a proportion that was somewhat, though not very much, higher than in the traditional asset distribution of these institutions. No sanctions were enforced against companies or banks that fell short of the recommended ratios. All recommendations mentioned in this section were terminated in 1962 or early 1963. Of the many agreements and recommendations in force during the 1950s there remain only those concerning liquidity ratios for commercial banks and control of bond issues.

The way in which the recommendations were observed was reported and discussed at meetings between representatives of the Riksbank and each group of credit institutions. Meetings are as a rule held every month for commercial banks, savings banks and insurance companies and provide an opportunity for a discussion of the general economic situation and the state of the credit market as well as of the trends observable in the activities of the credit institutions.

CONTROL OF BOND ISSUES

The enabling law of 1951 on the regulation of interest rates also contained provisions about control of bond issues, but it was never applied. The control of bond issues by the Riksbank is based on an agreement, made formal in 1952, with the commercial banks, which in Sweden are engaged in bond issues as agents and sometimes as underwriters. The banks may not participate in any issue the timing, amount, interest and repayment conditions of which have not been approved by the Riksbank. At times this control has functioned as a rather severe method of rationing access to the bond market, favouring the mortgage institutions engaged in housing finance and the power-producing companies. At present

it tends to act as a general control over the timing of issues in order to avoid congestion in the market.

It should be noted that the control of capital issues has never involved a scrutiny of and choice between the issues of individual firms. It may be described as a system of rationing as between the main categories of borrowers, in which the banks have acted as intermediaries between the Riksbank and the issuing firms.

THE CREDIT-POLICY LEGISLATION OF 1962

The laws mentioned earlier concerning cash reserves of commercial banks and the regulation of interest rates have been superseded by new legislation which entered into force on July 1, 1962. The new legislation comprises the Law concerning Liquidity Ratios and Cash Ratios for certain credit institutions, the Law concerning Investment Ratios for certain credit institutions and the Law concerning Control of Rates of Interest and Bond Issues.

All three are enabling laws, which can be put into operation by the government at the request of the Board of Directors of the Riksbank. Under the first law the Riksbank would have power to prescribe minimum cash ratios for commercial banks and the Post Office Bank and minimum liquidity ratios for commercial banks, savings banks, the agricultural credit associations and the Post Office Bank. Under the law on investment ratios the government could issue regulations to ensure the supply of credit to the central government and housing sectors from the insurance companies, the savings banks, the Post Office Bank and the new National Pension Insurance Fund. The law on interest rates and bond issues would permit the Riksbank to fix maximum lending rates and maximum and minimum deposit rates for credit institutions and to control bond issues.

There has been no need to have recourse to these laws.

ANNEX
WEEKLY RETURN AND EXPLANATORY NOTE

SVERIGES

WEEKLY

as at December 31,

Assets		In thousands of kronor
1. Gold coin and bullion	398,480	
2. Surplus value of gold	536,870	
		935,350
3. Foreign government securities	2,336,837	
4. Bills payable abroad	45,181	
5. Due from foreign banks and bankers, net	551,880	
		2,933,897
6. Other foreign assets		10,501
7. Swedish Treasury bills and bonds		4,683,088
8. Domestic bills	2,857	
9. Loans against collateral	31,787	
10. Advances on current account	20	
		34,664
11. Instalment loans		60,075
12. Pension funds deposited in the National Debt Office		6,768
13. Coin (other than gold)		10,044
14. Domestic cheques and bank drafts		25,723
15. Other domestic assets		118,244
16. Quota of Sweden in the International Monetary Fund		775,982
17. Sweden's shares of the capital stock of the International Bank for Reconstruction and Development, paid portion		103,464
Total		9,697,800

RIKSBANK

RETURN

1962

Liabilities	In thousands of kronor
18. Notes in circulation*	7,330,361
19. Bank drafts	19,668
20. Deposits on cheque account:	
Government institutions	151,926
Commercial banks	181,469
Other depositors	1,532
21. Deposits	904,031
22. Exchange adjustment account	137,723
23. Other liabilities	247,330
24. Capital	50,000
25. Instalment loan fund	65,000
26. Reserve fund	20,000
27. Building fund	50,000
28. Pension funds	6,768
29. Balance of profits brought forward	814
30. International Monetary Fund	530,029
31. International Bank for Reconstruction and Development	1,149
Total	9,697,800

* Maximum amount of note issue according to Law No. 106 of April 13, 1962 . . . . . Kr. 7,800,000,000·00

Unexercised right of note issue . . . . . Kr. 469,639,059·00

EXPLANATORY NOTE ON THE WEEKLY RETURN

ASSETS

1. GOLD COIN AND BULLION

Under this heading gold belonging to the Riksbank is booked at the value of, at present, Kr. 2,480 per kilogramme of fine gold.

2. SURPLUS VALUE OF GOLD

This item is the difference between the market value, at present Kr. 5,821·29 per kilogramme of fine gold, and the book value under item 1.

3. FOREIGN GOVERNMENT SECURITIES

This item is included in the secondary note cover (the Sveriges Riksbank Act, Article 10(*a*)).

4. BILLS PAYABLE ABROAD

This item is included in the secondary note cover (the Sveriges Riksbank Act, Article 10(*d*)).

5. DUE FROM FOREIGN BANKS AND BANKERS, NET

This item is included in the secondary note cover (the Sveriges Riksbank Act, Article 10(*e*)).

7. SWEDISH TREASURY BILLS AND BONDS

This item is included in the secondary note cover (the Sveriges Riksbank Act, Article 10(*a*) and (*b*)).

8. DOMESTIC BILLS

This item is included in the secondary note cover (the Sveriges Riksbank Act, Article 10(*d*)).

9. LOANS AGAINST COLLATERAL

This item is included in the secondary note cover (the Sveriges Riksbank Act, Article 10(*f*)).

10. ADVANCES ON CURRENT ACCOUNT

This item is included in the secondary note cover (the Sveriges Riksbank Act, Article 10(*f*)).

11. INSTALMENT LOANS

These loans are granted out of a special fund. See also item 25.

12. PENSION FUNDS DEPOSITED IN THE NATIONAL DEBT OFFICE

See also item 28.

16. QUOTA OF SWEDEN IN THE INTERNATIONAL MONETARY FUND

See also item 30.

17. SWEDEN'S SHARES OF THE CAPITAL STOCK OF THE INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT, PAID PORTION

See also item 31.

LIABILITIES

22. EXCHANGE ADJUSTMENT ACCOUNT

Exchange operations are booked on exchange account at a rate which lies between the purchase and the selling rates. The difference between book rates and market values is booked on the adjustment account. Since 1949 parts of the Riksbank's profit have also been transferred to the exchange adjustment account (see Sveriges Riksbank Yearbook 1959, page 72).

24. CAPITAL

The Sveriges Riksbank Act, Article 3: 'The capital of the Riksbank shall be 50 million kronor.'

26. RESERVE FUND

The Sveriges Riksbank Act, Article 4: 'The reserve fund of the Riksbank shall be 20 million kronor. If the reserve fund falls below that amount, at least 10 per cent of the Riksbank's yearly net profit shall be allocated to the reserve fund until it reaches the amount prescribed.'

30. INTERNATIONAL MONETARY FUND

The claim of the International Monetary Fund on Sweden in kronor. The difference between items 16 and 30 is Sweden's balance at the I.M.F. This amount is not included in the calculation of the Riksbank's gold and foreign exchange reserves.

31. INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

The claim of the International Bank for Reconstruction and Development on Sweden in kronor. The difference between items 17 and 31 is Sweden's balance at the I.B.R.D. This amount is not included in the calculation of the Riksbank's gold and foreign exchange reserves.

MAXIMUM AMOUNT OF NOTE ISSUE ACCORDING TO LAW NO. 106 OF APRIL 13, 1962

Law No. 106/1962 stipulates that the maximum amount of the note issue shall be Kr. 7,800 million. If an increase in the right of issue is deemed necessary as a result of exceptional circumstances, the King in Council may, if the Riksdag is not in session, upon the recommendation of the Board of Directors of the Riksbank and after consultation with the Board of Directors of the National Debt Office, permit the Riksbank to issue notes to an additional amount of not more than Kr. 700 million. Such permission granted by the King in Council shall, unless it is ratified by the Riksdag within twenty days after the commencement of its next ensuing session, become void at the expiration of the said period (see also Sveriges Riksbank Yearbook 1959, page 72).

SECONDARY NOTE COVER (ARTICLE 10 OF THE RIKSBANK ACT)

The Sveriges Riksbank Act, Article 10: 'That portion of the Riksbank's notes in circulation which exceeds the Bank's gold reserve must be covered by the following assets:

(*a*) easily realizable government securities,

(*b*) bonds of the General Mortgage Bank of Sweden and of the City Mortgage Bank of the Kingdom of Sweden, as well as such other Swedish bonds as are quoted on stock exchanges abroad,

(*c*) such gold coin and bullion deposited abroad or in transit therefrom, duly insured, as is not included in the gold reserve in conformity with Article 11,

(*d*) bills payable within the Realm or abroad,

(*e*) such deposits with banks or bankers abroad as fall due within six months, less any sums owing by the Riksbank to banks or bankers abroad,

(*f*) advances for a fixed period not exceeding three months or at not more than three months' notice made against such government securities and bonds as are defined under (*a*) and (*b*) as well as, up to an amount not exceeding 100 million kronor, against other security.'

THE END