

RECENT DEVELOPMENTS IN THE RELATIONS BETWEEN

GOVERNMENT AND CENTRAL BANK

A. Statutory provisions regarding ownership and management

"The State has in several countries manifested a strong tendency in recent years to claim a larger extent of participation in the ownership and administration of the central bank.

"In Denmark and New Zealand the former privately-owned central banks were converted into entirely State-owned central banks in 1936. In Paraguay a privately-owned commercial bank, the Bank of the Republic of Paraguay, was converted into a State-owned central bank in 1936. In Italy the central bank, whose capital was owned entirely by private shareholders, was transformed into an "institution under public law" in 1936, when the old capital and part of the reserves were repaid to the private shareholders and the new capital was subscribed by "public law" banks and credit institutions, savings banks, insurance companies and provident societies; and as the State already had a large share in the ownership and control of many of these institutions, it acquired an indirect participation in the ownership and administration of the Bank of Italy. In the same year the Government of Canada took steps to acquire a controlling interest in the capital of the Bank of Canada; and the process of conversion into a State-owned institution was completed in 1938 when the Government paid out all the private stockholders.

"With regard to administration, in New Zealand the State now has the power to appoint all the directors of the Reserve Bank, whereas formerly it was to nominate only three out of the seven directors (exclusive of the Governor, Deputy-Governor and Secretary of the Treasury); and the Secretary of the Treasury is now a member of the Board with voting power, which he did not have prior to 1936. In addition, it was laid down in the new law that the Reserve Bank 'is to give effect as far as may be to the monetary policy of the government as communicated to it from time to time by the Minister of Finance'. In Canada the State now has the right to appoint all the directors (exclusive of the Governor and Deputy-Governor), as compared with three out of the nine under the original statute. In Denmark the Chairman of the Board of three Governors is now to be nominated

by the King, and eight of the 25 directors are to be elected by the Riksdag from among its own members, two by the Minister of Trade, Industry and Shipping, and the remaining 15 by the Board of Directors, whereas formerly all the directors, except two who were appointed by the Minister of Trade, were elected by the General Meeting of private shareholders, and the Board of Directors appointed two or three out of the four or five managers of the Bank.

"Furthermore, while in the United States, Germany, France and Greece no change was made in the ownership of the capital, the State acquired a bigger share in the administration and control of the central bank.

"In Germany the provision in the Bank Law of 1924 that 'the Reichsbank is a bank independent of Government control' was repealed by an amending law in 1937, and the Reichsbank-Direktorium was placed directly under the Fuhrer and Chancellor. Under the law of 1924 the President of the Reichsbank was appointed by the General Council of the Bank with the countersignature of the Reichspresident, and when the General Council was eliminated it was provided that the President of the Reichsbank was to be appointed by the Reichspresident on the advice of the Direktorium (Management Board), and the other members of the Direktorium by the Reichspresident on the nomination of the President of the Reichsbank; but under the 1937 amendment the President and other members of the Direktorium are to be appointed by the Fuhrer and to be directly responsible to him.

"In France, where formerly the General Council of the Bank of France consisted of 15 regents elected by the 200 largest shareholders, the composition of the Council was radically changed in 1936, and provision was made for a large measure of direct and indirect State participation in appointments to the Council. In the first place, nine out of the 20 members of the Council are to represent 'the collective interests of the nation', three representing the Ministries of Finance, National Economy and Colonies, while the other six are ex officio members holding specified positions in State financial institutions. In addition, six members are to be appointed by the Minister of Finance from a list of three names submitted by each of six commercial, industrial, agricultural and labour organisations, while three are to be nominated or elected by the National Economic Council, the Central Committee of the savings banks, and the staff of the Bank of France, leaving only two to be elected by the General Meeting of shareholders.

"In Greece the Governor, Deputy-Governor and Sub-Governor are now to be appointed by the Cabinet of Ministers on the proposal of the Board of Directors, whereas prior to 1932 they were elected by the General Meeting of shareholders subject to the approval of the Government.

"In Argentina, on the other hand, where prior to 1935 some central banking functions were performed by a State-owned bank, the Bank of the Argentine Nation, the commercial banks now have an equal share with the State in the capital of the new Central Bank; and not only do the shareholding banks nominate six of the 12 directors from among their own representatives, and another four on the proposal of the Board of Directors and after consultation between the Board and certain representative organisations, but the President and Vice-President of the Bank are to be designated by the Chief Executive of the Argentine Nation in agreement with the Senate from among the three candidates for each post elected by the meeting of shareholding banks.

"In China, also, where the Central Bank is a State-owned institution, it was provided in the Monetary Reform Programme announced by the Minister of Finance in November, 1935, that the

'Central Bank is to be reorganised as the Central Reserve Bank of China and shall be owned principally by banks and the general public, thus becoming an independent institution, devoting itself chiefly to maintaining the stability of the nation's currency.'

"Owing to strong opposition from certain circles both within and outside the Government, this part of the Monetary Reform Programme was, however, not carried into effect.

"Moreover, in Salvador the capital of the Central Bank, which was established in 1934, was not only subscribed by the commercial banks and the public, but the Governor and Deputy-Governor are to be elected by the General Meeting of shareholders subject to the approval of the Government.

"With these exceptions, a definite trend in the direction of greater State participation in ownership and administration of central banks is to be observed in recent changes in central banking statutes. It is significant that such changes were made in the statutes of two newly-established central banks, the Reserve Bank of New Zealand and the Bank of Canada, within two years from their inception, as well as in the statute of one of the oldest central banks, the National Bank of Denmark.

"The Economic Intelligence Service of the League of Nations 1/ has also seen fit to draw attention to the fact that 'in the statutes as drawn up or amended in recent years, the State has generally assumed a more important role both in respect of the ownership and management of central banks', and that

'This tendency stands in contrast with that of the pre-war period and early post-war years, in particular when stress was laid on the desirability of preserving or increasing the independence of central banks from the State,'

even to the extent of inserting in the statutes of new or reorganized central banks 'a clause or a sentence emphasising this independence either as regards ownership or management'.

Source: "Central Banking" by M. H. DeKock,
pp. 320 - 324.

1/ "Monetary Review 1937-38", p. 81.

B. Extension of monetary functions of central banks

Functions of Central Banks have been significantly extended in several respects in recent years.

a. Open market operations

"While genuine open-market operations are, and can be, undertaken at present on a relatively large scale only by the Bank of England and the Federal Reserve System of the United States, owing to the existence of wide and active markets in short-term and long-term Government securities in London and New York respectively, the central banks of many other countries, old and new, have recently been exerting themselves to establish some or other form of open-market operations as a supplement to discount-rate policy and as an instrument for neutralising seasonal movements or movements of Government funds or for insulating the internal credit structure from sudden and temporary changes in the balance of payments.

1/ "Annual Report for 1930", pp. 15-16.

"A number of the older central banks, however, could not undertake open-market operations until they were specifically empowered by amendments to their statutes to buy and sell Government bonds, Treasury bills and similar securities for their own account. This was done, for example, in Germany in 1933, Holland and Norway in 1936, Belgium in 1937, and France in 1938.

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b. Control over reserves

"A new development in connection with the statutory centralization of cash reserves is that of giving the central banking authorities the power to decrease or increase the minimum cash reserves to be kept with the central bank by the commercial banks. It was first introduced in the United States in 1933 in 1935."

"New Zealand followed suit in 1936 when the Governor of the Reserve Bank, acting with the authority of the Minister of Finance, was empowered to vary the percentages of balances to be maintained by trading banks with the Reserve Bank, subject to such balances not being at any time less than those provided for in the original statute; and in Australia the Monetary and Banking Commission recommended in 1937 that the Commonwealth Bank Board be empowered, subject to the consent of the Treasurer, not only to require trading banks to hold minimum balances with the Commonwealth Bank for limited periods, but also to vary the reserve percentages within the limit fixed by the consent of the Treasurer."

Source: "Central Banking" by M. H. DeKock
pp. 336-337
338-9

D. Loss of functions and Control to governments

In spite of these developments, however, it cannot be doubted that in recent years governments have increased their share in the formulation and administration of monetary and financial policies at the expense of central banks.

In a way this is merely a reflection of the obvious need for unified control over all monetary, financial and fiscal policies when such policies become of increasing importance. But such unified control might logically be seated either in the central bank or in the government. That the tendency has definitely been a shift from central banks to governments is due to at least two factors.

(1) During the last depression the strictly monetary policies of central banks were recognized to be of smaller importance than the fiscal policies of the Treasury. If any coordinating had to be done, it was quite natural that the Treasury should do it rather than the central bank. This is merely a particular application of the general principle of the dog wagging its tail rather than vice versa. (2) This explanation does nicely for the United States where deficit policies loomed large and the government through the sale of its securities became dominant in the whole credit situation. But a similar trend is perceptible in countries where active fiscal policy did not play such a role. An additional explanation is needed. It may be in fact that governments rather than central banks are the actual centers of authority either democratically elected or dictatorially established. It is natural that powers come to be exercised by them rather than by the central banks, who are slower to respond to changes in political authority, and are therefore side-stepped in the formulation of policies and the exercise of functions. Their vague inheritance of semi-independence thus actually is a millstone around their necks.

Assuming the role of central banks through making them responsible public institutions

Commenting on the forces that motivate the actions of the Bank of England, the London Economist said: "Yet there is the danger that the City may become a law to itself, and that the Bank may unconsciously acquire powers which more properly belong to the Government; and may even judge questions from the standpoint of the " city "as distinct from the nationIf the Bank is to retain its independence and its unofficial leadership in financial and monetary matters, it is necessary to lay down several guiding conditions,"1/ which include a control and leadership that is entirely disinterested, and a far greater degree of publicity regarding the actions of the Bank.

Regarding the constitution of the Bank, the Economist has the following to say 2/

"In theory, the Bank is a private institution, charged with certain duties, both statutory and unwritten, but controlled by its shareholders, who in theory elect the Governor, Deputy-Governor and Court of Directors, and are also ultimately responsible for the appointment and retirement of the Bank's staff. In practice, certain changes have taken place during recent years. The Governor is no longer elected for only two years, for the present Governor has held office since 1920. The present Deputy-Governor has risen from the staff of the Bank, thereby carrying into effect Bagehot's suggestion that the Deputy-Governor should correspond to the permanent head of a Government department. The directors of the Bank no longer represent exclusively 'City' interests, and two of the directors are now fulltime and fully-paid employees of the Bank. The Governor has also recruited a personal staff of technical advisers, and of these two have come to the Bank from the Treasury. Finally, it is inconceivable that the Governor could continue to hold office in opposition to the wishes of the Government of the day or that a new Governor could

1/ Economist, August 10, 1935
2/ August 17, 1935

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be elected without the de facto approval of the Cabinet.

"The main need, therefore, is for a codification of what has already become accepted practice. The exact legal ownership of the Bank's capital is comparatively unimportant. The Bank has long ceased to make its profits a major consideration, and the profits arising from the note issue already accrue by statute to the Exchequer. A legal limitation of the Bank's profits at approximately their present level would please public opinion and would involve little real change. There is little to be gained or lost by transferring to the State the ownership of the Bank's capital, which may reasonably be left as it stands at present. It is of greater importance to make it clear that the Governor, not the Court, is in control of policy -- as he really is today -- and that the Government has the final word in his appointment, as in the case of any other important public servant. Thus, in future, the election of the Governor -- and possibly the Deputy-Governor -- should be made subject to the approval of the Cabinet."