III. MAJOR CAUSES OF CHANGES IN THE VOLUME OF MONEY

(a) GOVERNMENT BORROWING FROM THE BANKING SYSTEM

91. It can be seen from the table in paragraph 80 above that only £19·5 million of the increase of £271 million in the volume of money which took place between June 1935 and June 1955 can be attributed to Government borrowing from the banking system. The choice of the end of June as our date for comparison is, however, a little misleading in this case for, in the past two years, the Government's debt to the banking system has been unusually low at the end of June in relation to its average debt during the year. A better indication of the changes which have taken place is given in the table below, which shows annual averages of the Government's indebtedness to the banking system:

Government Indebtedness to the Banking System

(£ million)

Calendar Year	Reserve Bank Investments in New Zealand [1]	Reserve Bank Holdings of Treasury Bills [2]	Total Borrowing from Reserve Bank	Trading-bank Investments in Government Securities [2]	Total Borrowing from Banking System	Public Account Balance with Reserve Bank [2]	Net Indebtedness to Banking System
1935	1·5	..	1·5	[3]	[3]	3·8	[3]
1936	1·5	0·3	1·8	5·2	7·0	2·6	4·4
1937	2·4	0·7	3·1	7·6	10·7	4·0	6·7
1938	2·1	3·3	5·4	7·6	13·0	2·4	10·6
1939	2·1	14·0	16·1	11·3	27·4	1·1	26·3
1940	2·6	22·0	24·6	16·5	41·1	2·7	38·4
1941	2·6	17·2	19·8	20·3	40·1	4·6	35·5
1942	3·0	23·3	26·3	27·2	53·5	7·4	46·1
1943	8·4	33·5	41·9	36·1	78·0	8·2	69·8
1944	9·6	34·3	43·9	36·1	80·0	5·7	74·3
1945	7·5	24·1	31·6	29·3	60·9	3·6	57·3
1946	1·7	35·4	37·1	26·2	63·3	3·9	59·4
1947	0·7	28·9	29·6	20·9	50·5	1·6	48·9
1948	4·8	35·3	40·1	17·0	57·1	1·5	55·6
1949	34·7	37·2	71·9	12·9	84·8	1·0	83·8
1950	26·9	52·2	79·1	11·7	90·8	3·2	87·6
1951	17·1	50·5	67·6	11·7	79·3	3·4	75·9
1952	11·3	50·0	61·3	11·7	73·0	2·8	70·2
1953	20·5	50·0	70·5	11·7	82·2	−2·2	84·4
1954	9·3	36·7	46·0	23·0 [4]	69·0 [4]	1·7	67·3 [4]
1955	10·7	32·7	43·3	23·1 [5]	66·4 [5]	2·3	64·1 [5]

[1] Average of monthly figures up to 1945: Average of weekly figures thereafter.
[2] Average of monthly figures.
[3] Not available.
[4] Includes £11 million of State Advances Corporation stock.
[5] Includes £11·5 million of State Advances Corporation stock.

92. The major feature which emerges from this table is that the Government's debt to the banking system has not fallen as greatly in the past six years as the end of June figures suggest. If we studied changes in the average of the volume of money over the twelve months of a calendar year, the increase in the volume of money would be greater and the contribution of Government borrowing to the increase which has taken place since 1935 would be found to be in the vicinity of £40 million.

93. The Government borrows from the banking system when the total of the money it receives from taxation, loans, and other non-banking sources proves insufficient to finance its total expenditure. It is unwise to attach too much significance to changes from one year to another, because an increase in debt to the banking system may merely reflect temporary recourse by the Government to what really amounts to

overdraft accommodation due to an unexpectedly slow inflow of tax or loan moneys. For instance, part of the increase in the Government's borrowing in 1949 may be ascribed to a rather sudden drying up of sources, such as Post Office Savings Bank and the farm stabilisation accounts, upon which it had come to rely for a substantial contribution towards its capital works programme. Nevertheless, if there were a persistent rise in indebtedness to the banking system, it would suggest that the Government was adopting a deliberate policy of financing a portion of its expenditure by inflating the money supply, rather than by taxation or by borrowing part of the existing supply of money.

94. The Government may inflate the money supply either by borrowing from the trading banks or by borrowing from the Reserve Bank. There is an important difference, however, between the two methods of inflation. When the Government borrows from a trading bank, the bank gives it a cheque in return for an interest-earning Government security. The cheque is deposited by the Government in the Reserve Bank, which takes payment from the trading bank by deducting the amount from the bank's balance at the Reserve Bank. The initial effect, therefore, is to increase Government deposits (which are money) and reduce bankers' deposits at the Reserve Bank. When the Government spends the money, the cheques which it issues are likely to be lodged by the recipients with their trading banks, thus increasing total deposits there. When the trading banks present the cheques to the Reserve Bank for payment, they regain as a group the balances at the Reserve Bank which they lost when they paid for the Government securities. The effect of the transaction is to increase customers' deposits at the trading banks while the total reserves of the banks are restored to their original level. Since the ratio between the reserves of the banks and their customers' deposits has declined, their ability to lend further has been somewhat reduced. The above assumes that none of the money borrowed is spent on imports or kept in circulation as notes and coin by the public. If it were so spent, the banks' ability to expand their lending would be even more significantly reduced.

95. The immediate effect of Government borrowing from the Reserve Bank is similar to the effect of borrowing from a trading bank. The Reserve Bank gives the Government a deposit (which is money) in return for an interest-earning Government security. When the Government spends the money, the people receiving the cheques pay them into their trading banks, thus increasing customers' deposits there. The banks present the cheques to the Reserve Bank for payment and are credited with the amounts concerned in their accounts at the Bank. Thus their reserve balances at the Reserve Bank and the ratio between these balances and their customers' deposits are increased. Their ability to lend is improved, provided there is no increase in the reserve ratio requirement or in the severity of other controls on their lending. And, as we have seen, the ultimate effect of an addition to their reserves, if they can find borrowers, is a multiple expansion of their customers' deposits and, therefore, of the supply of money. The extent of the expansion will depend on the ratio which they must preserve between reserves and deposits. Thus Government borrowing from the Reserve Bank is potentially more inflationary than borrowing from the trading banks. The practical importance of increases in Reserve Bank lending to the Government is for this reason considerably greater than appears

from tables showing causes of changes in the volume of money, for these record only the initial impact of the changes in Reserve Bank credit. But part of the increase in the volume of money which is attributed to trading-bank advances has been made possible only because greater Reserve Bank lending has increased the banks' reserves and, therefore, their ability to lend.

96. There have been important changes in Government policy towards borrowing from the trading banks during the period considered. Up till 1943, it was normal practice for the trading banks to invest in Government loans, and from 1936 to 1943 their investments in Government securities rose from £5·2 million to £36·1 million. As from 1943, the Government decided not to permit the trading banks to subscribe to Government loans and repaid their existing securities as they matured. As a result of this policy and as shown by the table in paragraph 91, the banks' holdings of Government securities had fallen to £11·7 million by 1950, a figure very little above that ruling in 1939.

97. The new Government continued the policy of preventing the banks from subscribing to Government loans, but permitted them to maintain their existing holdings at about £11·7 million. Apart from a temporary investment of £0·5 million by one of the banks in 1954, there has been only one departure from this policy since 1950. In January and March 1954, the banks were invited to invest a total of £12 million in State Advances Corporation stock to assist in financing the Government's housing programme. Later we shall discuss the desirability of such a course at a time when labour and resources are fully employed.

98. The Government may borrow from the Reserve Bank in three ways:

(a) It may sell the Bank long-term securities;
(b) It may issue to the bank Treasury bills which mature in three months' time;
(c) It may obtain an overdraft at the bank.

99. The extent to which the Government may borrow on overdraft from the Reserve Bank or issue Treasury bills to the bank is limited by the Reserve Bank Act. Borrowing on overdraft is limited to the extent that the amount owing at any time during any financial year must not exceed one-quarter of the total revenue of the preceding year; and in that the amount owing at the end of any financial year must not exceed the total revenue of that year which remains outstanding and unpaid and is properly payable into the Public Account. (Section 35 of Public Revenues Act 1953.)

100. The Bank is also not permitted to:

> grant accommodation, either directly or indirectly, to the Treasury, or to any incorporated Department of State . . . by way of discounts, loans, advances, overdrafts, or otherwise, in excess of the revenue or estimated revenue for the year in the case of the Treasury, or one-fourth of their respective revenues or estimated revenues for the year in the case of any other Department of State. (Section 14 (i) of Reserve Bank of New Zealand Act 1933.)

101. However, these limitations are ineffective because there is no limitation on the power of the Government to borrow by selling long-term securities to the bank. The practical effect of all three methods is the same and, at present, the State pays 1 per cent for all three types of accommodation.

102. The Government had little recourse to Reserve Bank credit up till 1938, when its total borrowing from the Bank was about £5½ million. The Government indicated in its 1939 Financial Statement that it realised that New Zealand at the time was *"not suffering from a shortage of money, but from a shortage of what money will buy"*; but its indebtedness to the Reserve Bank increased by £10·7 million in the calendar year 1939 as compared with 1938. Likewise, in the Financial Statements for 1940, 1942, and 1943, it was stressed that it was *"infinitely better for everybody that the measure of the sacrifice required from each and every one to carry on the war should be made out of our current income"; ". . . to proceed on the principle of pay as we go"*; because *"creation of credit takes away by unseen methods the value of work done and savings made and ultimately in the form of price increases hits those most who have to spend their incomes on necessaries of life"*. However, the Government apparently felt forced in the circumstances to borrow further from the bank, mainly by issuing Treasury bills, and by 1944 total Government borrowing from the Reserve Bank had reached £44 million. Most of the borrowing was attributed specifically to its housing programme, and some to its public works programme; little was attributed to war purposes.

103. As indicated earlier, the Government set its face against reliance on bank credit after 1943. Its record of war finance, as a consequence, compares favourably in this respect with that of any other country. By 1947 it had reduced its debt to the Reserve Bank to £30 million. However, this reduction was more than offset in the next two years and, by 1950, the level of Government borrowing from the Reserve Bank was nearly £50 million greater than in 1947. £20 million of the increase resulted from an issue of Government securities to the Reserve Bank in compensation for a loss which the Bank incurred on its holdings of foreign exchange as a result of the appreciation of the exchange rate in 1948. This merely provided the bank with an interest-bearing security and did not add to the volume of money in New Zealand. The bulk of the remainder of the increase took place in the financial year 1949–50 when the Government increased its net indebtedness to the bank by over £18 million. As mentioned earlier, this was used to finance part of the Government's works programme due to a shortage of investment money after the exchange adjustment of 1948.

104. Since 1950 the declared policy of the Government has been to reduce its indebtedness to the Reserve Bank. Buoyant revenues enabled the debt to be reduced from £79 million in 1950 to £61 million in 1952. However, after a substantial deficit in the balance of payments, the money market became tight in 1952 and, in an endeavour to relieve pressure on the limited funds available and to avoid a rise in rates of interest, the Government decided not to raise a public loan during the year ending March 1953. To finance its expenditure it used Reserve Bank credit, and drew on accumulated balances in the Public Account. As a result, the Reserve Bank's holdings of Treasury bills and Government stock rose again to a level of nearly £71 million in the calendar year 1953. However, the downward trend was resumed from 1953 onwards, and the average indebtedness of the Government to the Reserve Bank in 1955 was about £43 million.

105. Looking at Government borrowing from the banking system as a whole, the greatest increase (from £13 million to £80 million) took place between 1938 and 1944. Between 1944 and 1947, £30 million was repaid, but in the next three years, despite a reduction of £9 million in debt to the trading banks, total debt to the system rose by £40 million. (This includes the £20 million of securities issued to the Reserve Bank on account of the exchange adjustment.) Since then, with the exception of 1952–53, the Government's indebtedness has been consistently reduced and in 1955, at £66 million, stands about £25 million below the 1950 total.

(b) OTHER RESERVE BANK ADVANCES

106. The table on page 265 shows the changes which have taken place in the various assets of the Reserve Bank since 1936.

107. The table reflects the fact that the Reserve Bank lends money to the Government, to certain marketing organisations, and to the trading banks when they require loans to help meet reserve ratio requirements.

108. In 1936 the Government set up a Primary Products Marketing Department, with an Internal Marketing Division which took over the marketing of eggs, fruit, and honey, and an External Marketing Division, which handled all exports of dairy produce. During the war the Department was also given responsibility for marketing meat and wool and several other minor products. Thus the Reserve Bank took over the financing of many marketing activities previously catered for by the trading banks; and, incidentally acquired a large amount of sterling from the sale of exports which would normally have been acquired by the trading banks.

109. In 1946, wool marketing returned to its normal channels and was no longer financed by the Reserve Bank. However, when the marketing of dairy produce and meat was handed over during the next two years to the Dairy Products Marketing Commission and the Meat Producers' Board respectively, these bodies continued to receive overdraft accommodation from the Reserve Bank. With the termination of the bulk purchase contract for meat in September 1954, the trading banks once again resumed full responsibility for financing meat marketing, but the Reserve Bank still acts as the banker of the Dairy Products Marketing Commission and the organisations concerned with the marketing of apples and pears, citrus fruits, honey, eggs, and milk. The Dairy Products Marketing Commission and these other organisations retain the privilege of obtaining overdraft accommodation at 1 per cent per annum.

110. The distinction between Reserve Bank and trading-bank financing of the marketing of produce is similar to that between Reserve Bank and trading-bank financing of the operations of Government. Reserve Bank advances are potentially more inflationary in that they add to the reserves of the trading banks and thus, in the absence of offsetting movements of the reserve ratios, make possible a multiple expansion of trading-bank credit.

111. The Reserve Bank's "other advances and discounts" included until 1951 only the drawings on credits granted by the Government to France (£5 million) in 1947 and to Czeshoslovakia (£1 million) in 1948 to buy New Zealand wool. The Czechoslovakian loan was repaid in

Assets of the Reserve Bank: Weekly Average for Calendar Year

(£ million)

Year	Reserve		Subsidiary Coin	All Marketing Advances	Advances to State for Other Purposes	Other Advances and Discounts		Investments		Other Assets	Total Assets
	Gold (at Cost)	Exchange (¹)				Trading Banks	Other	In New Zealand	Overseas		
1936	2·8	20·8	0·2		1·3	..	..	1·5	0·5	0·1	27·2
1939	2·8	5·3	0·2	6·1	13·6	..	..	2·1	1·6	0·2	31·9
1942	2·8	22·5	..	6·8	23·1	..	..	3·0	1·2	1·5	60·9
1945	2·8	60·1	..	2·1	24·2	..	..	7·5	4·3	1·5	102·4
1948	2·8	65·1	0·1	1·7	35·2	..	2·4	4·8	5·7	7·5	125·4
1950	4·3	51·6	0·2	5·1	52·2	..	5·4	26·9	4·4	2·3	152·3
1951	5·1	62·9	0·5	3·4	51·1	0·8	6·0	17·1	10·0	3·2	160·2
1952	5·9	24·7	0·6	2·3	50·8	0·1	6·0	11·3	30·2	1·8	133·6
1953	6·0	59·1	0·6	4·8	53·2	..	6·0	20·5	23·0	1·0	174·2
1954	6·1	74·9	0·6	6·7	38·4	3·4	5·5	9·3	23·6	0·9	169·5
1955	6·2	46·7	0·6	17·4	35·6	5·9	5·0	10·7	23·0	0·9	152·3

(¹) Prior to 1950, the figures cover sterling exchange only: thereafter they include "Other Exchange" formerly shown under "Other Assets".

May 1954, and the French loan falls due for repayment in December 1957. The effects of such loans are equivalent to an increase of similar amount in marketing advances.

112. It was not until 1951 that the Reserve Bank was called upon, for the first time, to lend to the trading banks. The extent of trading-bank borrowing is examined in more detail later when we consider the Reserve Bank's credit control policy, but it can be seen from the table on page 265 that, on the average of weekly figures for the calendar year, the trading banks were in debt to the extent of £800,000 in 1951 and of £100,000 in 1952; that they had no need to borrow in 1953; and that their debt to the bank rose to a weekly average of £3·4 million in 1954 and £5·9 million in 1955. A trading bank borrows from the Reserve Bank when the ratio between its balances at the bank and its customers' deposits falls below the reserve ratio minimum requirement. The borrowing of £1 million from the Reserve Bank, of course, adds that amount to its basic reserves. The fact that the Reserve Bank is prepared to lend to the trading banks in this way does not directly increase the volume of money, but enables the banks to avoid the necessity of rapidly calling in loans or selling investments, of a value several times the shortage in their basic reserves, in order to meet the statutory reserve ratio. The Reserve Bank decides the rate of interest at which it will lend to the banks.

(c) TRADING-BANK CREDIT

113. The following table gives an indication of the outlets which have been available for the funds of the trading banks during the period under review:

Trading-banks' Assets: Monthly Average for Calendar Year

(£ million)

Year	Coin and Bullion	Reserve Bank Notes	Balances Held in Reserve Bank	Gross Overseas Assets	Securities Held: Government	Securities Held: Other	Advances and Discounts	Land, Buildings, etc.	Total Assets
1935 ..	0·8	3·6	5·3	21·9	(1)	(1)	45·9	(1)	(1)
1939 ..	0·7	3·9	11·1	6·7	11·3	0·3	54·2	1·9	90·1
1943 ..	0·6	4·6	27·7	11·9	36·1	1·6	43·0	1·9	127·4
1946 ..	0·7	7·0	60·2	14·0	26·2	2·3	58·3	2·0	170·5
1949 ..	1·5	8·7	75·9	22·0	12·9	1·8	82·0	2·3	207·1
1950 ..	1·7	9·8	75·2	24·8	11·7	1·7	94·1	2·6	221·5
1951 ..	1·5	11·5	70·3	37·3	11·7	1·5	133·1	3·1	270·0
1952 ..	1·5	11·1	51·1	26·6	11·7	1·3	166·6	3·6	273·5
1953 ..	1·5	10·6	93·1	25·6	11·7	2·3	134·5	4·1	283·4
1954 ..	1·4	11·1	79·4	26·0	12·0	13·2 (2)	154·8	4·5	302·3
1955 ..	1·4	10·2	56·9	11·7	11·6	13·6 (3)	180·0	5·3	306·6

(1) Not available.
(2) Includes £11 million of State Advances Corporation stock.
(3) Includes £11·5 million of State Advances Corporation stock.

114. The banks' investments (other than those in Government securities already discussed) are small and mainly in local body securities. Holdings of such investments rose from £300,000 in the late 1930's to £2½ million in 1944–45, after which they slowly declined to £1·3 million in 1952. They increased to £2·3 million in 1953 and have since remained at about that total.

115. The New Zealand trading-banks' total holdings of securities comprise a much lower percentage of their deposits than is the case in most other countries. The ratio of securities to total deposits was 8·2 per cent in 1935 and rose gradually to 35 per cent in 1943. As a result of the change of Government policy as regards bank purchases of Government stock, and of the large increase in deposit liabilities, this ratio fell to 5·1 per cent by 1952, since when it has risen to 8·7 per cent as a result of the purchase of State Advances stock.

116. In the light of their relatively low holding of securities, and in the absence of any short-term money market which would enable the banks to invest in commercial or Treasury bills as can banks in countries with more fully developed money markets, the New Zealand trading banks must rely heavily on advances to customers in order to earn revenue. This can be seen from the figure for advances and discounts in the table above. (Discounts are a negligible proportion ($2\frac{1}{2}$ per cent in March 1955) of the total advances and discounts.)

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

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

The Period from 1935 to 1949

118. The question arises why trading-bank advances were responsible for only £35 million or 22 per cent of the increase of £161 million in the volume of money between June 1935 and June 1949. We have seen that the extent to which trading banks can lend depends on these factors:

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

(ii) The ratio which they are required to keep between their balances at the Reserve Bank and their deposit liabilities and the rate of interest charged by the Reserve Bank for loans to the trading banks.

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

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

We discuss these matters in turn in relation to the banks' lending between 1935 and 1949.

(i) *The Ratio Between Basic Reserves and Deposit Liabilities*

119. It is well known that the major banks in the United Kingdom aim, if possible, to maintain a ratio of about 8 per cent between their cash (i.e., their notes, coin, and balances at the Bank of England) and their customers' deposits; and a ratio of about 30 per cent between their liquid assets (i.e., their cash plus their loans to discount houses and holdings of Treasury and commercial bills) and their customers' deposits. As far as we could ascertain, the New Zealand banks do not work to any similar rules. Naturally, in the absence of any short-term money market offering facilities for investment of money at call or very short notice, New Zealand banks must for safety hold a much larger proportion of their assets in the form of bankers' cash than their British counterparts. Mr Whyte, Chairman of the Associated Banks, expressed the personal view that, given holdings of securities similar to those held by the banks early in 1955, trading banks should aim at having bankers' cash at about 20 to 25 per cent of their deposit liabilities. However, as indicated in the table below and in the more detailed table in Appendix H, there has been no consistency in the ratio between bankers' cash and deposits in the period which we are discussing, and for the bulk of the period this ratio has been considerably above the level cited by Mr Whyte.

Proportions Between Selected Assets of the Trading Banks and Their Customers' Deposits, 1935 to 1949

Average of Monthly Figures for Calendar Year	Bankers' Cash([1]) to Total Deposits	Bankers' Cash([1]) Plus Net Overseas Assets to Total Deposits	Securities to Total Deposits	Advances and Discounts to Total Deposits
	Per Cent	Per Cent	Per Cent	Per Cent
1935 ..	15·5	48·7	8·2	73·7
1938 ..	17·5	28·2	12·0	85·1
1943 ..	30·6	41·0	35·0	40·0
1946 ..	44·8	53·0	18·8	38·5
1949 ..	45·4	53·1	7·7	43·2

([1]) Bankers' cash includes notes and coin and balances at the Reserve Bank of New Zealand.

120. The ratio of bankers' cash to deposits may appear to have been low, at 15·5 per cent, in 1935, but this must be considered in conjunction with the relatively large amounts of foreign exchange held by the banks at that time. Had they wished they could readily have converted a fair proportion of these into balances at the Reserve Bank. Together, cash and net overseas assets were equal to nearly 49 per cent of the banks' deposit liabilities, which is a very "liquid" position. The next three years, however, saw a progressive decline in this ratio, until it reached 28 per cent in 1938. This was mainly a reflection of the substantial deficits in the balance of payments experienced in this period which reduced the banks' net overseas assets by nearly £14 million. In the same period (1936 to 1938) advances increased by only £10 million and deposits by £3½ million. In 1938 the banks must have been very close to what they would consider a prudent minimum level of reserves.

121. The period from 1938 to 1946 saw very considerable increases in the cash reserves and to some extent in the net overseas assets of the trading banks. Their balances at the Reserve Bank rose from £6·7 million to £60·2 million; their net overseas assets from £7 million to £12·6 million. The major cause of the rises was the continued surpluses in the balance of payments noted above. Much of the excess sterling from these surpluses was deposited with the Reserve Bank by the marketing authorities; but when the New Zealand equivalent of these funds was paid out to producers, or lent to the Government through investment in Government securities of the primary industry reserve accounts, the cheques drawn on the Reserve Bank eventually came into the hands of the trading banks. Their balances at the Reserve Bank were in turn built up when they presented these cheques for payment. During the same period, the Government borrowed quite heavily from the Reserve Bank and this added further to the cash reserves of the trading banks. By 1946, the ratio of cash to deposits was 45 per cent and the ratio of bankers' cash and net overseas assets to deposits 53 per cent. During the whole of the war, advances and discounts remained below the levels they had reached in 1938, and in 1946 were only £2·4 million above the 1938 level. It is clear, however, that trading-bank advances were not prevented from expanding by any shortage in reserves of bankers' cash or net overseas assets.

122. Advances rose by about £24 million between 1946 and 1949, but this was offset to some extent by a fall of £14 million in investments. Continued surpluses in the balance of payments and further Government borrowing from the Reserve Bank built up cash reserves and net overseas assets sufficiently to maintain the ratios between these items and total deposits in 1949 at figures comparable with those ruling in 1946.

123. Over the whole period 1935 to 1949, the banks' holdings of bankers' cash and net overseas assets rose by £70 million, but bank advances rose by only about £36 million and securities by about £10 million. Thus there was no multiple expansion of bank credit on the basis of the increased reserves; in fact, the banks expanded their lending by an amount equivalent to only two-thirds of their increased holdings of cash and overseas funds.

(ii) *The Statutory Minimum Reserve Ratios*

124. No shortage of reserves, therefore, prevented a substantial expansion of bank credit during this period. Nor did the statutory reserve ratios do so. The minimum balances required to be kept at the Reserve Bank remained throughout at 7 per cent of demand liabilities and 3 per cent of time liabilities respectively. The actual ratio maintained by the banks was always well above these figures.

(iii) *Other Controls on Advances*

125. As mentioned previously, a selective advance control policy, administered by the Reserve Bank, was in operation from January 1942 onwards. No statutory regulations were introduced, and in its administration of the policy the Reserve Bank relied on the voluntary co-operation of the trading banks. In wartime, the policy was not directed to reducing the level of advances, but to preventing their expansion

for speculation and for other purposes deemed inconsistent with the war effort, such as purchases of property, repayment of mortgages, finance of hire purchase or other credit sales, and luxury purchases.

126. This policy was continued after the war. In May 1947 and again in January 1948 the Reserve Bank made public statements outlining the general scope and requirements of the Government's policy. These made it clear that advances for purely investment purposes, for capital expenditure for business, industrial, and commercial purposes including the purchase of farm properties, and (except for short periods pending the raising of finance from non-banking sources) for building, purchasing, or refinancing of dwellings were brought within the restricted classes.

127. From the outset, all marginal or doubtful cases or cases involving special circumstances have been referred to the Reserve Bank for decision, provided always that the trading bank concerned was prepared to make the advance in question. In order to safeguard the confidential relationship between customers and their own bankers, the Reserve Bank has never asked that the name of any applicant be divulged.

128. It is impossible to assess how great a part the selective advance control policy played in holding down the level of advances during the period. An obvious imperfection of the policy is that the banker cannot be sure that an advance is used for the purpose for which it has been granted. But the policy probably exerted some restrictive influence in the period up till 1949.

(iv) *The Availability of Credit-worthy Borrowers*

129. The main reason for the relatively moderate expansion of bank advances during the period 1938 to 1949 was undoubtedly lack of demand for them. Several factors were responsible for this. First of all there was a shortage of imports during the war and early post-war years and the Government paid for a much larger share of the imports than before the war; secondly, during the same period, the Reserve Bank financed the marketing of many primary products; thirdly, as men were drafted into the forces, the level of business activity in New Zealand declined to some extent and many firms engaged on war contracts received advance payments from the Government; fourthly, many activities were subject to direct controls (e.g., the demand for advances for private building purposes was low because building controls prevented an undue diversion of scarce resources into this field); and, fifthly, the overall stabilisation policy prevented any marked rise in prices, wages, and other costs, which, if it had occurred, would have necessitated higher advances.

130. Advances rose between 1946 to 1948 as imports increased, the banks regained the finance of wool exports, business returned to a peacetime basis, and controls were to some extent relaxed. But, even in 1948, fairly comprehensive import controls, controls over domestic prices and incomes, and building controls continued in operation; and the financing of meat, dairy produce, and several other primary products remained with the Reserve Bank, thus lessening the demand for trading-bank credit. In 1948–49, a small decline occurred in trading-

bank advances, probably due to the general disinflationary effect of the exchange appreciation of 1948 and, in particular, to the consequential temporary lowering in the domestic value of imported goods.

131. In brief, the position of the trading banks in 1949 was that they were holding large reserves of cash and foreign exchange in relation to their deposit liabilities; their advances were not subject to control through the reserve ratio system, and they had been unable to expand advances greatly, partly because of the selective advances control policy, but primarily because of lack of demand for bank credit in the prevailing circumstances.

The Period from 1949 to 1955

132. The following tables show the changes which have taken place since 1949 in the banks' advances (and discounts), in the overdraft limits which they have granted, but which have remained unexercised, and in the relationship between some selected bank assets and customers' deposits.

TABLE A—Trading-bank Advances and Unexercised Overdraft Limits, 1949 to 1955: Monthly Average for Calendar Year

(£ million)

Calendar Year	Advances and Discounts	Unexercised Overdraft Limits	Total
1949	82·0	57·7	139·7
1950	94·1	64·2	158·3
1951	133·1	72·2	205·3
1952	166·6	69·9	236·5
1953	134·5	93·5	228·0
1954	154·8	110·3	265·1
1955	180·0	100·8	280·8

TABLE B—Proportions of Selected Assets of the Trading Banks to Their Customers' Deposits, 1949 to 1955

Calendar Year	Bankers' Cash to Total Deposits	Bankers' Cash and Net Overseas Assets to Total Deposits	Securities to Total Deposits	Advances and Discounts to Total Deposits
	Per Cent	Per Cent	Per Cent	Per Cent
1949	45·4	53·1	7·7	43·2
1950	41·8	50·2	6·5	45·4
1951	32·5	43·2	5·2	52·0
1952	24·9	31·6	5·1	65·2
1953	39·2	46·8	5·2	50·1
1954	31·8	38·7	8·7	53·6
1955	23·7	30·2	8·7	62·3

133. There have been three main movements in the level of bank advances during this period. First, a sharp rise from 1949 till the middle of 1952; second, a sharp fall until early 1953, followed by several months of relative stability; and third, in 1954, a gradually accelerating rise, reaching a peak in March 1955, followed by a further period of relative stability with a tendency for advances to decline for the remainder of 1955.

1949 to 1952: The Demand for Advances

134. The demand for bank credit increased greatly between 1949 and 1952, due to a combination of circumstances. As indicated earlier, many controls over domestic spending and incomes and over imports were removed or substantially relaxed during these years. At the same time, both export and import prices rose and this increased the demand for advances both directly and indirectly. For instance, the spectacular increases in the price of wool in 1950 and early 1951 forced wool buyers and woollen mills to apply to the banks for more accommodation. Meat-freezing companies were similarly affected by a consequential rise in fat stock prices. The situation in respect of exports was further complicated by the prolonged waterfront dispute in the first half of 1951, which forced export industries to hold produce in store for a considerable period. Manufacturers and traders sought more accommodation to meet higher costs of imported materials or finished goods and to pay the higher wages necessitated by intensified competition for labour and by general increases granted by the Court of Arbitration in May 1950 and February 1951.

135. Moreover, there was a general tendency for all producers and traders to expand their businesses and increase their stocks to take advantage of the buoyant demand generated by these developments. Gross private capital expenditure (including changes in stocks) rose by £61 million between the year ending March 1950 and the year ending March 1952, and it is probable that bank overdrafts, directly or indirectly, played an important part in financing this expansion. As the 1952 Economic Survey pointed out, "*overdraft rates were lower than those which would have to be paid on long-term capital (after taking into account cost of issue) and interest on overdraft is a deductible expense for taxation purposes, whereas dividends are not*". Moreover, the volume of imports for the year ending June 1952 was 48 per cent higher than in the year ending June 1950. Imports became available in the second half of 1951 and early in 1952 in unexpectedly large amounts, due to increased production overseas and to the closing of alternative markets by credit restraints and import controls. Traders who had become accustomed during the post-war period of shortages to expect prolonged delays in delivery and to order more than they really required for immediate delivery were suddenly confronted with goods which they had ordered but not expected to arrive nearly so promptly. Many could not pay for these goods without assistance from their banks. For all the above reasons, the demand for bank credit was substantially increased.

Reserves of the Trading Banks

136. As we have seen, the trading banks in 1949 were in a strong position to meet this demand. Despite the large increase in their advances, balance of payments surpluses resulted in the cash reserves of the banks as a whole being maintained at a high level in relation to the increasing deposits of their customers throughout 1950, and for most of 1951. (See Table B in paragraph 132.) In this connection, it should be noted that the wool retention scheme, though it temporarily withheld a large amount of money from the wool growers, did nothing to freeze the additional reserves of overseas exchange and bankers' cash which the banks acquired as a result of the deposit of the extra money with them.

137. However, the continued expansion of the banks' advances, combined with a substantial loss of bankers' cash and foreign exchange reserves mainly due to a large balance of payments deficit in 1951–52, led eventually to a marked fall in the ratios of bankers' cash and net overseas assets to their deposits. The lowest point was reached at the end of March 1952, when the ratio of bankers' cash to deposits for the banks as a whole was 18·1 per cent, and the ratio of bankers' cash plus net overseas assets to deposits 26·4 per cent. At that time, even though the statutory minimum reserve ratio had still not been altered from the level set in 1934, one bank was forced to borrow from the Reserve Bank to maintain its statutory balance there, while others were forced to obtain temporary assistance from a primary producers' organisation for the same purpose.

Controls Over Advances

138. Although the Reserve Bank did not raise the statutory reserve ratios during this period, it made some attempt to restrain the expansion of advances by moral suasion. In the first half of 1950 the selective advance control policy was relaxed to some extent, all advances up to £2,000 being freed from control and the banks being given a greater degree of discretion in doubtful cases. However, in October 1950, steps were taken to tighten up the policy. These included requests to the banks to require shorter periods of repayment of advances, stricter attention to existing reduction programmes, tightening up on new limits, and critical examination of old ones. At this stage also the banks were asked to have regard to the quantitative aspects of advances. They were asked to tighten up generally by adopting a more cautious attitude to all requests for advances and not to pursue actively new advance business. From time to time in this period the need for caution was emphasised.

139. In November 1951, a directive was issued bringing advances for trading purposes (e.g., for stocks) within the scope of the advance control policy for the first time; and requesting the banks not to increase importers' overdraft limits without approval; although temporary "tiding-over" finance could be granted for periods up to three months in view of the abnormal circumstances which had arisen in respect of imports. In addition, the banks were asked to examine all

overdraft accounts where limits exceeded £10,000 and where customers were leaning too heavily on bank accommodation in relation to the capital structure of their businesses.

140. That the foregoing measures proved quite ineffective in the circumstances in preventing a continued expansion, both of advances and of the total volume of bank credit granted, is shown by the following table:

Movements in Bank Advances and Unexercised Overdraft Authorities, 1950 to 1952

(£ million)

Last Wednesday in Month	Advances and Discounts	Unexercised Overdraft Authorities	Total Credit Granted
1950—October	97·1	67·7	164·8
1951—January	112·6	72·3	184·9
April	135·9	73·7	209·6
July	121·4	78·4	199·9
October	143·2	67·3	210·6
1952—January	159·3	67·3	226·6
April	186·6	63·8	250·4

141. Examination of the table in Appendix H, showing the classification of trading-bank advances, indicates that the bulk of the increase in advances between March 1951 and March 1952 resulted from higher advances to merchants and wholesalers (whose advances nearly doubled), to retailers, and to industries other than primary production and processing. Many of the extra advances made in the later part of 1951 and the early part of 1952 were to importers, who had not previously arranged overdraft limits adequate to meet the cost of imports which had arrived for them. In the interests of New Zealand's credit standing overseas, the Reserve Bank permitted tiding-over finance to be granted in most of these cases to enable payment to be made. Indeed, according to the Governor of the Reserve Bank, the banks were officially requested to grant such finance, although, he said, they did not relish the prospect of carrying such high advances. However, it is clear that, quite apart from this temporary embarrassment, a substantial expansion of credit occurred despite the continued requests for restraint from the Reserve Bank in the period which we have considered. By the end of 1952, the trading-banks' liquid assets had fallen to a relatively low level and some of them were borrowing to maintain their required balances at the Reserve Bank.

1952 to 1954: The Demand for Advances

142. The following table shows a sharp fall of about £52 million in advances between April 1952 and April 1953 followed by a period of relative stability until the end of 1953:

Movements in Bank Advances and Unexercised Overdraft Authorities, 1952 to 1954

(£ million)

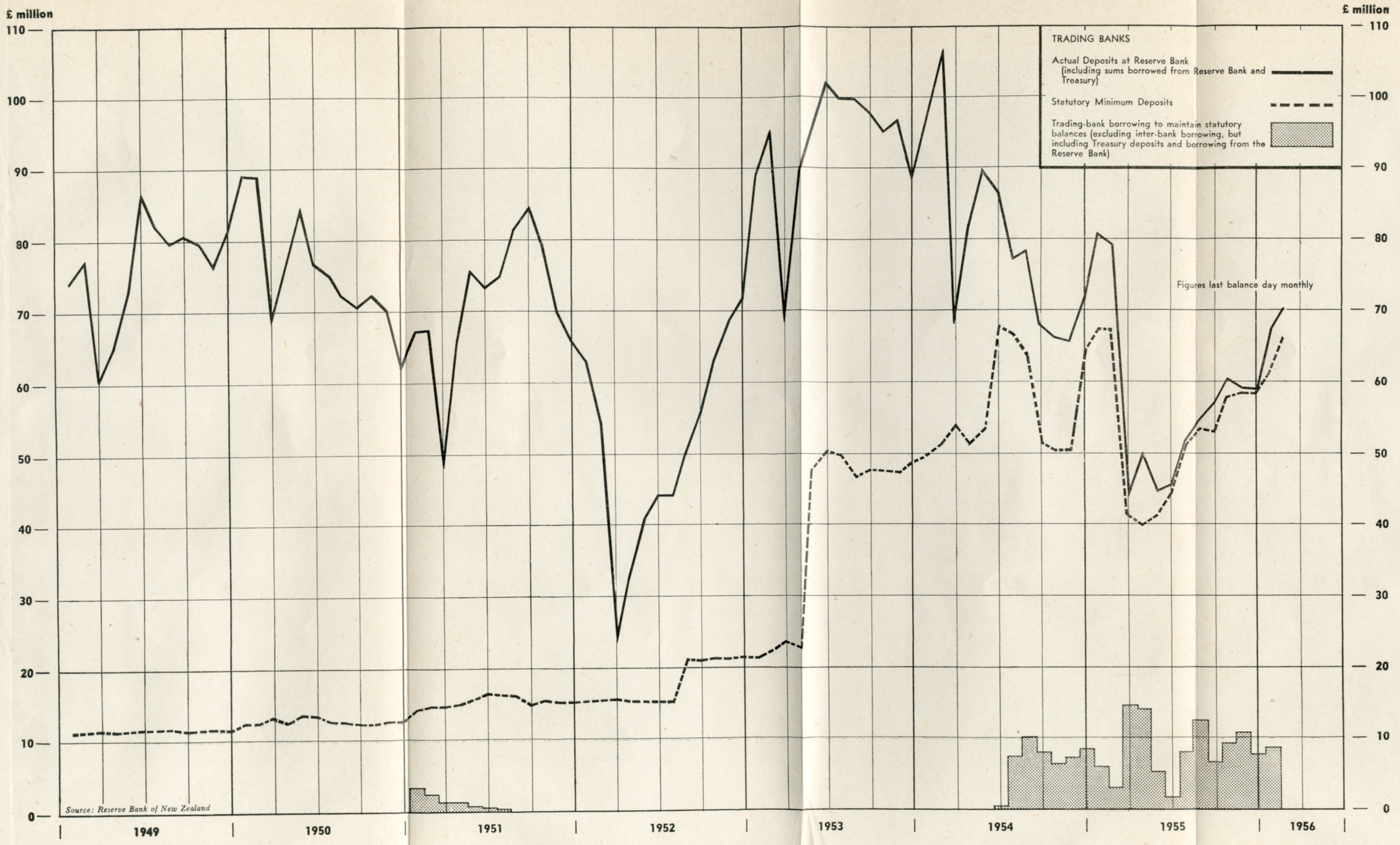
Last Wednesday in Month	Advances and Discounts	Unexercised Overdraft Authorities	Total Credit Granted
1952—April	186·6	63·8	250·4
July	171·2	67·7	238·9
October	159·4	71·7	231·1
1953—January	135·3	87·3	222·6
April	134·9	89·7	224·6
July	129·5	94·1	223·6
October	138·8	98·9	237·7
1954—January	135·8	107·0	242·9

143. The total amount of credit granted also fell between April 1952 and April 1953, but only by about £26 million, and after the middle of 1953 total overdraft limits began to rise again. The fall in bank advances between April 1952 and April 1953 was due partly to a more restrictive lending policy by the banks, but mainly to a fall from the high level prevailing in 1951–52 in the demand for bank credit. Many traders had overstocked in the import boom of 1951–52, and their demand for finance for imports fell away markedly in 1952–53. The exchange allocation scheme introduced in April 1952 and a falling tendency in import prices also reduced payments for imports to some extent. As excess stocks were run down, many advances were repaid.

Reserves of the Trading Banks and Control of Advances

144. A change in Reserve Bank policy was initiated during this period. In August 1952, the statutory minimum reserve ratios were raised for the first time to 10 per cent in respect of demand deposits and 5 per cent in respect of time deposits. Notice of this change had been given to the banks in December 1951. In December 1952, by informal agreement with the banks, the ratios were raised again to 15 per cent and 7½ per cent respectively. In May 1953, there was a further increase to 20 per cent and 10 per cent. However, as the graph facing page 276 shows, the actual balances held by the banks more than kept pace with the increases in the amounts which they were required to keep at the Reserve Bank. (This graph is based on Table 34 of Appendix H.)

145. The banks' reserves were increased primarily by surpluses in the balance of payments and by an increase in Government borrowing from the Reserve Bank in 1952–53. Certainly, the increases in the ratios left them with less free bankers' cash than they would otherwise have held, but the margin which they retained was considerable. On the average during 1953, the banks held bankers' cash equal to 39 per cent of their deposits. Thus it is unlikely that the increases in the statutory reserve ratios played any significant part in the fall of advances in 1952 and their subsequent stability in 1953. Indeed, towards the end of 1953, the overdraft limits granted by the banks were again increasing although, up till the end of that year, this had not been reflected in any significant expansion of advances.


£ million
110
100
90
80
70
60
50
40
30
20
10
0
TRADING BANKS
Actual Deposits at Reserve Bank (including sums borrowed from Reserve Bank and Treasury)
Statutory Minimum Deposits
Trading-bank borrowing to maintain statutory balances (excluding inter-bank borrowing, but including Treasury deposits and borrowing from the Reserve Bank)
Figures last balance day monthly
Source: Reserve Bank of New Zealand
1949
1950
1951
1952
1953
1954
1955
1956

1954 to 1955: The Demand for Advances

146. From January 1954 to April 1955 advances rose by over £51 million, while the total volume of credit (including unexercised overdraft authorities) granted by the banks rose by £46 million, as the following table shows:

Advances and Unexercised Overdraft Authorities, 1954 to 1955

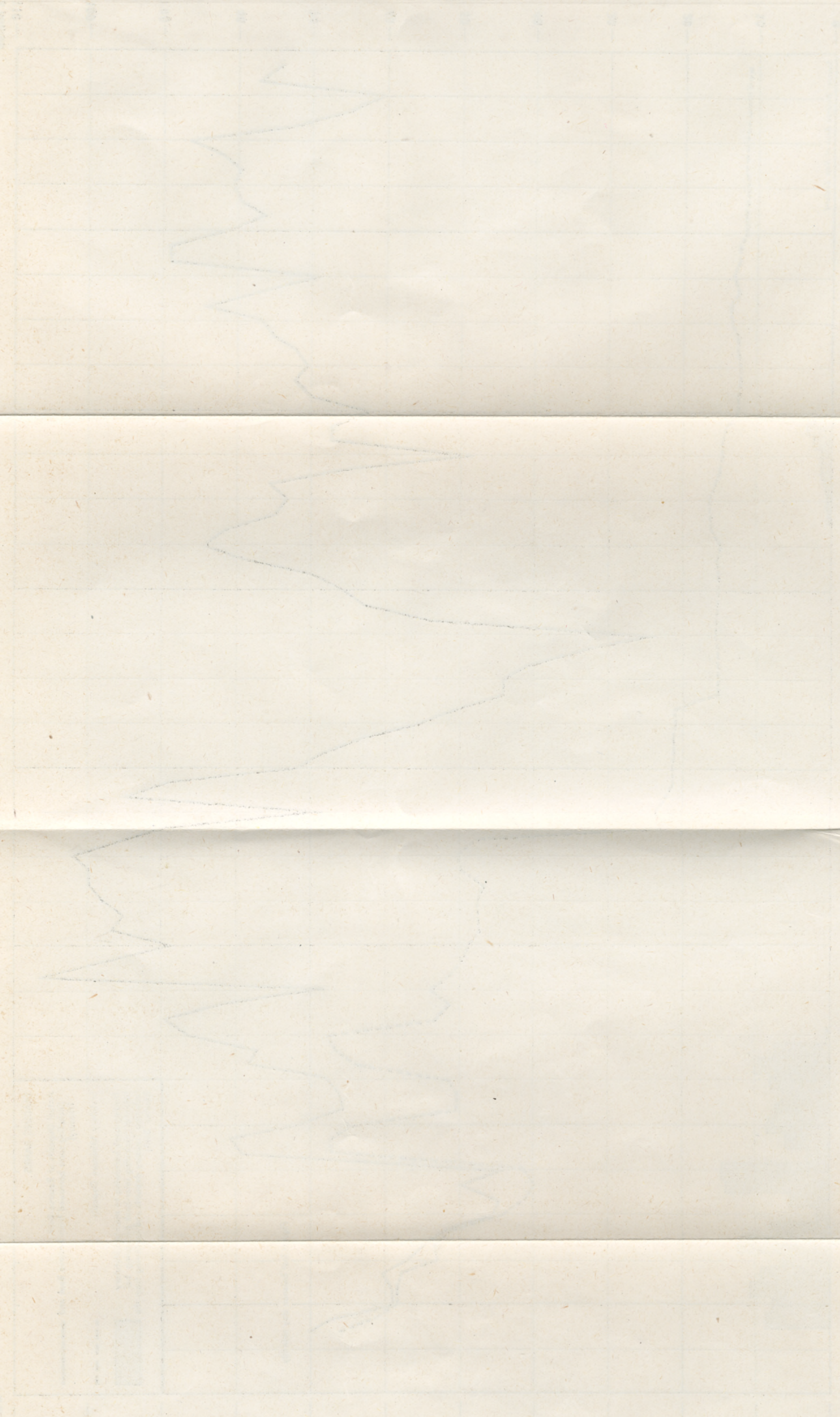
(£ million)

Last Balance Day in Month	Advances	Unexercised Overdraft Authorities	Total Credit Granted
1954—January ..	135·8	107·0	242·9
April ..	148·1	110·3	258·4
July ..	156·3	112·3	268·6
October ..	170·4	109·9	280·3
1955—January ..	167·6	112·7	280·3
April ..	186·9	102·3	289·2
July ..	184·2	100·5	284·7
October ..	178·1	95·0	273·1

147. Table 36 in Appendix H, which shows the classification of trading-bank advances, indicates that nearly £9 million of the increase in advances between March 1954 and March 1955 was to freezing works, meat companies, etc., affected by a delay in payments due to a change in marketing procedures after the termination of the bulk purchase contract. The remainder of the increase was well spread throughout the community – an extra £5 million to farmers; £3½ million to industries processing primary products; £6 million to manufacturers; £4½ million to merchants; £4½ million to retailers; £2 million to private individuals. The country was again spending heavily on capital investment and on imports, and drawing on the banks to help them to finance this spending.

Reserves of the Trading Banks and Control of Advances

148. The Governor of the Reserve Bank had mentioned to the Chairman of the Associated Banks, in February 1954, his concern at the increase in unexercised overdraft authorities, and in April 1954, when discussing the impending removal of exchange allocations, had told the banks of the necessity *"to keep a much closer contact with customers, especially importing customers"*. But, despite the large amount of bankers' cash held by the banks over and above the reserve ratio requirement in late 1953 and early 1954, no increase was made in the statutory reserve ratios until 31 May 1954, when advances were £12 million and total credit granted £17 million greater than in January 1954. Then the ratios were raised to 25 per cent in respect of demand deposits and 12½ per cent in respect of time deposits. They were maintained at this level for three months and then lowered to 20 per cent and 10 per cent between 1 September, when the Government was raising a loan of £30 million, and 1 December. The Governor of the Reserve Bank told the Commission that he had asked the banks to get in touch with customers whom they thought could subscribe to the loan. They had assured him of their co-operation, but had pointed out that if they succeeded in inducing customers to subscribe, they would lose cash to the Reserve Bank. Accordingly, the bank lowered the



ratios temporarily *"to allow that loan through"* and apparently also granted a small amount of overdraft accommodation interest free to the trading banks which had been temporarily forced to borrow even at the reduced ratios. From 1 December 1954 to 28 February 1955, the ratios were raised again to 25 per cent and 12½ per cent.

149. The Reserve Bank's interest rate for lending to the trading banks was raised from 1½ per cent to 3½ per cent in April 1954 and to 4 per cent in November 1954. However, despite these changes, the Reserve Bank was obviously making no real effort at this stage to ensure that the trading banks would be penalised if advances increased. Their policy appears to have rested on the assumption that, if the banks were left with only a narrow margin of free cash, they would feel obliged to follow a cautious lending policy in order to avoid borrowing from the Reserve Bank. Total interest payments by the trading banks to the Reserve Bank between May 1954 and 31 March 1955 were only £42,000, and virtually the whole of this was paid by the Bank of New Zealand. In the meantime, between the end of May 1954 and the end of February 1955, trading-bank advances had increased by a further £16 million and the total of advances and unexercised overdraft authorities by £21 million.

150. Between the end of February and the end of March 1955, bank advances rose by £25 million and bankers' cash fell by nearly £37 million. By the latter date the ratio of bankers' cash to deposits had fallen to 18 per cent and of bankers' cash plus net overseas assets to deposits to 27 per cent. Part of the rise in advances was due to increased requirements by meat exporters, but the major portion was a reflection of the use of bank overdrafts to pay income taxes, a practice which always raises advances in March of each year. The drain of bankers' cash was abnormally large, primarily because the Government built up a substantial balance in the Public Account as a result of an overall surplus for the year 1954–55, and partly because of a continuing deficit in the balance of payments. The drain would have been even larger if the Treasury had not placed with the four private banks short-term deposits, which rose to a peak of about £16 million early in April. The banks were charged only ½ per cent for this temporary accommodation which was finally paid off by the beginning of June; in total, they paid only £18,000 to the Treasury for it. In addition, the Reserve Bank had again lowered the reserve ratio requirements to 15 per cent of demand deposits and 7½ per cent of time deposits as from 28 February. Both of these adjustments were made because the Treasury and the Reserve Bank felt that the banks had lost cash *"for reasons unrelated to their own lending policies"* and should not be penalised on this account.

151. After March, the Reserve Bank, recognising that the level of bank advances was excessive, raised the statutory ratio in respect of demand deposits in small steps on four occasions, until the requirements reached 24 per cent in respect of demand deposits and 7½ per cent in respect of time deposits on 7 October 1955. These increases served to keep the banks as a whole "in the red" at the Reserve Bank, to an amount of about £10 million on the average between April and December. Also abnormally large amounts of sterling were sold to the Reserve Bank in order to avoid borrowing. About 55 per cent of the borrowing in these months was by the Bank of New Zealand and, in mid-December, this bank borrowed £3 million from the Treasury for a short period. However,

the Bank of New Zealand always held notes and overseas assets considerably in excess of its borrowings from the Reserve Bank. The General Manager has informed the Commission that the Bank of New Zealand's holdings of notes have been no more than adequate to service its day-to-day business, which includes a substantial number of transactions on behalf of the Government. It is estimated by the Reserve Bank that the Bank of New Zealand requires to hold an additional £3 million of notes throughout the year, and £5·5 million over the Christmas period, on account of its Government business. Because of this need to hold substantial quantities of notes, the Bank of New Zealand is granted overdraft accommodation by the Reserve Bank when required, free of interest up to £3 million or £5·5 million whichever is appropriate. The General Manager also informed the Commission that, as a matter of principle, his bank preferred to maintain a Reserve Fund of £3·575 million in British Government securities. He believed that the holding of a proportion of its reserves and assets in other than New Zealand stock added strength to its operations through diversity of investment. Taking into account the bank's business in Australia, Fiji, and Samoa, he said that its liquid assets overseas were no more than adequate to serve the day-to-day requirements of the bank.

152. The Reserve Bank's interest rate on borrowing by the trading banks was raised on three occasions in 1955 – from 4 per cent to 5 per cent in July to 6 per cent in September and to 7 per cent in October. As a result, interest payments by the banks to the Reserve Bank increased, £86,000 being paid between 1 April and 30 September and £52,000 between 1 October and 31 December.

153. Concurrently, advances fell from £189 million at the end of March 1955 to £176 million at the end of December 1955, and total credit granted fell from £288 million to £273 million in the same period. However, as at the end of December 1955, advances were still £10 million higher than in December 1954, although total credit granted had fallen by £6 million in the same period. How far this greater restraint in lending was due to the firmer policy adopted by the Reserve Bank during the period cannot be estimated. In the light of their relatively low holdings of bankers' cash, and of the continuing deficit in the balance of payments, it would appear to have been in the interests of the banks themselves to follow a conservative lending policy, irrespective of the level of the reserve ratios or of the interest rate charged by the Reserve Bank. Mr Whyte confirmed in evidence that the banks would have been following similar policies to those now being pursued, whether or not reserve ratio controls had been in force.

(d) OVERSEAS TRANSACTIONS

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

Effects of Overseas Transactions on the Volume of Money, 1935 to 1955

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

155. The causes of these changes in the balance of payments position are discussed elsewhere in this report. At this stage, it is only necessary to note that a surplus in the balance of payments not only has the direct effect on the volume of money indicated in the table above, but also, by adding to the basic reserves of the trading banks, makes possible an expansion of trading-bank credit. A deficit has the opposite effect. The expansion of bank advances which has occurred during the period which we have surveyed would not have been possible in the absence of the large additions which have been made to the banks' reserves through surpluses in the balance of payments.

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

157. During the last twenty years the Government has taken several measures, outlined in more detail above, to protect the economy from some of the effects which arise from increasing overseas prices. It is interesting to consider the effect of these measures on the volume of money. The stabilisation schemes for dairy produce and meat withheld from the farmers some of the proceeds from the sale of their produce overseas; but these proceeds were not "frozen" at the Reserve Bank in the name of the marketing organisations concerned. They were invested in Government securities and spent by the Government on capital works, thus becoming deposits or notes in the hands of those paid by the Government. At the same time, the expansion of deposits increased the basic reserves of the trading banks, thus increasing their ability to lend. However, the stabilisation schemes for these products were an important part of an overall system of stabilisation made possible by the co-operation of important sections of the community, which fairly effectively

held down costs and prices for several years and thus helped to limit the demand for bank advances during that period. Therefore, while the stabilisation schemes did not directly reduce the volume of money in circulation, or the banks' ability to lend, indirectly they played an important part in curtailing the demand for credit and thus holding the volume of money below the level which it would otherwise have reached.

158. The exchange appreciation of 1948 was another measure which offset some of the effects of rising overseas prices. One result of making £100 sterling worth only £100(N.Z.) instead of £125(N.Z.) as before, was to reduce the value in New Zealand money of produce exported to 20 per cent below the level which would otherwise have ruled. In the case of wool this meant that less deposits were made available to growers and less cash made available to the trading banks than they would otherwise have received. In fact, wool receipts rose almost enough to give growers the same return and the banks the same accretion of cash as before. In the case of dairy produce and meat, the returns to producers were in any case, under the stabilisation scheme, unrelated to external receipts, so that the appreciation had no immediate effect on the payments to them. But the exchange appreciation reduced the amounts of New Zealand money which would have been added to the stabilisation accounts, and thus reduced the amounts available for investment in Government securities. As we have seen, as a result of this and other circumstances, the Government increased its borrowing from the Reserve Bank. Thus, while the immediate effect of the appreciation was to reduce the volume of New Zealand money made available through export receipts, the effect of this reduction was offset to some extent by subsequent Government borrowing from the Reserve Bank.

159. The New Zealand price of imports was also reduced by the appreciation of the New Zealand pound, and this meant that less New Zealand money and, therefore, less drain on the banks' reserves of cash and foreign exchange, was involved in buying imports of a given sterling value. From this side then, since the volume of imports remained relatively stable in the following year, the volume of money, and the banks' ability to lend, were reduced less than would otherwise have been the case.

160. The net effect of the appreciation was probably in the direction of reducing the volume of money. Indirectly it reduced the demand for bank advances by reducing the domestic price of goods with a high export or import content, and by removing some of the factors which might otherwise have provided justification for a general increase in wages. Since costs were held below the level which they would otherwise have reached, producers and traders needed less advances to finance their operations.

161. The wool retention scheme "froze" temporarily in trading-bank accounts about £32 million of the proceeds from the sale of wool in the "boom" year 1950–51. The volume of money was thus temporarily reduced below the figure which it would otherwise have reached. But nothing was done to "freeze" the additional reserves which the banks acquired as a result of the deposit of this money with them and their ability to lend was thereby increased. If these amounts had been "frozen" at the Reserve Bank, it is probable that the trading banks would have been unable to expand advances to as great an extent as they did in 1951–52.

162. The foregoing paragraphs illustrate the importance of overseas transactions in governing the supply of money and the general level of economic activity in New Zealand and indicate some of the difficulties involved in attempting to insulate the economy from the effects of fluctuations in prices overseas. We discuss these difficulties in more detail elsewhere. The almost continuous rise in export and import prices, and the overall surpluses which have occurred in the balance of payments, have been basic causes of the increase in the volume of money which has occurred since 1935. The direct and indirect effects of the price rises made a large increase in bank advances essential; the surpluses in the balance of payments provided the banks with a large proportion of the basic reserves necessary to meet the increased demand for accommodation. Whether the increases in bank advances and in the supply of money which have taken place should be regarded as excessive is examined elsewhere.

Section Three: New Zealand's Credit System

I. THE IMPORTANCE OF THE CREDIT OR DEBT SYSTEM

163. A notable characteristic of any reasonably advanced economy, based primarily on the institutions of private ownership and enterprise, is the existence of a large volume of debt. At the same time (although this is not universally appreciated) there exists a large volume of credit, since a loan of money within the country simultaneously creates an asset for the creditor and a liability for the debtor. In general, debt is the consequence of the use of one person's savings by others.

164. Many witnesses who appeared before us, especially those who had some connection with the Social Credit movement, expressed great concern at the growth of public and private indebtedness in New Zealand in recent years, and some witnesses claimed that it was unnecessary for debt to exist in the economy at all. It seems desirable, therefore, to examine the importance of debt and credit, and the structure of the debt or credit system in New Zealand.

Is Debt Necessary?

165. The efficiency of any economy, and, therefore, the standard of living which the people of that economy can enjoy, depends very largely on the ability and willingness of the people to build up and maintain an adequate stock of productive capital. Modern techniques of production and sale require large and expensive factories and warehouses, shops and offices, machinery and tools. There must be efficient means of transport by road, rail, sea, and air, and adequate supplies of power. In the case of farming, buildings and machines and adequate fencing, drainage, etc., are required; the soil or pasture must be maintained or improved by the application of fertiliser; and livestock must be reared for breeding or production. Producers generally must hold stocks of raw materials, semi-finished, and finished goods to maintain continuity of production; to overcome disruptions of supply due to transport stoppages,

etc., or to meet as quickly as possible the fluctuating demands of producers and consumers. Moreover, the efficiency of producers depends heavily on housing and household facilities, and on the premises and equipment used for educational and health services.

166. Thus, in a modern economy, only a relatively small proportion of the population is engaged in producing goods which will immediately be sold to consumers. Nevertheless, it is the fact that in the past so much of our effort has been devoted to building up and maintaining our stock of capital, which has largely made possible the standard of consumption which we now enjoy. Our stock of capital per head must be maintained if we wish to preserve our standard of living and it must be increased if we want to improve that standard.

167. To maintain or increase the capital assets required for an efficient economy necessitates using the services of workers who, and resources which, might otherwise be directly producing consumer goods and services. These workers and resources and their products must be paid for, and to enable them to be paid for either new money must be created for the purpose or some persons must forego the right to use existing moneys to buy consumer goods. This being so, and on the assumption that we wish to retain the means of production predominantly in private hands, it seems clear to us for reasons given below that indebtedness of one section of the community to another is inescapable.

168. Few private individuals or small groups of individuals could provide from their own incomes or from their accumulated savings sufficient money to finance the building, equipment, and stocking of a modern factory or shop, or the purchase and development of a farm. If people wish to obtain control of productive capital of this kind, they must induce other persons, either directly or through some financial institution, to lend part of the money necessary to pay for such capital.

169. Similar considerations apply in the case of persons who wish to own their own home or to obtain relatively expensive home utilities. In the long run, many could no doubt save sufficient to pay for these things out of their own resources – but, since life is short, it is often judged more desirable to borrow the money necessary and repay it over a period of time.

170. Local authorities also require money to pay for installation of water and sewerage facilities, roads and footpaths, reserves, and so on. Many of the authorities could avoid borrowing by sharply increasing their rates to cover all capital expenditure. But this would impose an intolerable financial burden on ratepayers in relation to annual income. It is usually much more equitable and convenient to borrow from those (either within or outside the locality) who have money to spare, so that ratepayers may pay for their amenities over a number of years.

171. The Central Government could, if it wished, raise all the money necessary for its capital works programme from taxation, and, especially at times when resources are fully employed, there is merit in its doing so. But it is often more convenient – and may have a less adverse effect on the incentive to produce – to raise part of its requirements through voluntary loans rather than through compulsory taxation. Again, as several witnesses stressed, the Government has the power to avoid completely the necessity of borrowing (or taxing) for its public works by

requiring its central bank to issue money to it. But as we point out in Part IX of Appendix E, it would generally be most unwise to do so; for, if workers and resources were fully employed, as they have been in New Zealand in recent years, continual injections of new money of this magnitude would merely drive up costs and prices, as the members of the community competed with one another to spend the increasing supply of money on a relatively constant supply of goods and services. Thus the Government's requirements would be met, not at the expense of those most able to pay, but at the expense of those least able to increase their incomes to keep pace with rising prices. In circumstances of full employment some must save in order to enable public works to proceed. The Government must choose between borrowing the voluntary savings of the thrifty members of the community on the one hand and forcing people to restrain their consumption either through taxation or through rising prices caused by inflation on the other.

172. If expansion of the money supply through Government borrowing from the banking system were resorted to continuously and prices persistently rose, the public would ultimately lose confidence in the value of money and the entire monetary and economic system would be violently disrupted. Similar considerations are relevant to proposals made to us by some witnesses that all capital expenditure, public and private, should be financed by the issue of new "debt-free" credits rather than by borrowing money already in existence. One needs only to note that the total of private and public capital expenditure in New Zealand was £211 million in 1954–55 to appreciate the extravagance of such proposals.

Why Should Interest be Paid?

173. Many witnesses claimed that the fact that interest had to be paid on borrowed money imposed an intolerable burden on the community and that steps should be taken at least to reduce and probably to abolish interest. The subject of interest is a complex one and cannot be discussed adequately in a short space. We discuss it more fully in the main sections of our report. Suffice it to say here that the payment of interest serves three main useful purposes:

(a) It encourages saving.
(b) It induces those with money available to lend it.
(c) It acts as a restraint on excessive demands for loan money and thus makes it easier to apportion the available supply.

174. If no interest were paid, there would be little inducement to lend money. Losing control of money by lending it inevitably involves risk that the borrower will be unable or unwilling to repay, the degree of risk depending on the nature of the borrower. Some reward is therefore necessary to induce people to lend rather than to hoard. A reward is also necessary to induce people not to spend their money. For instance, if no interest could be earned on money lent, more people would buy property and let it, or buy other assets, from which they could earn an income or derive satisfaction, and which they could sell again for money in the future. This applies particularly when people expect prices of property and other assets to rise. Moreover, the collection and lending of money by the financial institutions, which are the most important sources of loan money in New Zealand, is by no means a costless process and some reward must be paid to cover the costs

involved. Those persons who must be employed to collect deposits and premiums, interview applicants for loans, examine their credit worthiness, and so on, must receive their salaries or wages and the buildings and equipment they use must be paid for and maintained. If no interest could be earned on loans, financial institutions – if they managed to survive – could pay no interest on deposits, and would have to charge much more for the services they provide to depositors or policy holders. It is not generally recognised that the abolition of interest would adversely affect not only a few wealthy people or financial institutions, but also all owners of deposits at trading and savings banks, those holding insurance policies or subscribing to superannuation schemes, members of building societies, and so on. (We discuss these points again in Part VIII of Appendix E.)

175. The other main function of interest is to provide some restraint on demands for loan money, and to serve as a device for the apportionment of the available supply. As we have seen, obtaining control of large sums of money is useful to many persons, for it enables them to adopt more efficient or less costly methods of production and thus, in many cases, to increase their profits. That is why they are willing to pay interest for a loan. The lower the rates of interest are, the more capital projects become profitable, provided the existing level of costs and prices is maintained. In addition, the lower the rates of interest are, the less sacrifice is involved for consumers or public authorities in borrowing to increase their assets. Thus, with lower rates of interest, the demand for loan money is likely to be greater. Rates of interest tend to rise when loan money becomes scarcer in relation to the demand for it and to fall when it becomes more plentiful. Many people regard it as unfair that the price of loan money should rise when it becomes scarce; but before this view is accepted it is necessary to examine the alternatives to allowing the price to rise.

176. If rates of interest threaten to rise to levels higher than the Government thinks desirable, because the demand for loan money is outstripping the supply, the Government can hold them down in two main ways:

(a) The Government can issue more money through the banking system to meet the demand for loans. This might be desirable if resources were not fully employed. However, as we have seen, our resources are too limited to allow everyone to have everything he wants, and when resources are fully employed, the main effect of the issue of new money would be rising prices. In these circumstances, an attempt to maintain a "fair" rate of interest by such means could result in forcing up the prices of goods and services to a level "unfair" to a large section of the community.

(b) The Government can fix interest rates for various types of loans and prohibit the charging of rates greater than the fixed rates. But there are difficulties involved in such control, and the greater the difference between the controlled rates and the rates which would rule in an uncontrolled market, the greater these difficulties would be. For instance, if the demand for loan money is greatly in excess of the supply, some attempt must be made by the State to apportion what is available and especially to ensure that "essential projects" receive an adequate share. This involves the necessity for decisions by a State authority on a rather arbitrary basis as to which firms or local authorities shall be permitted to raise money and which shall not. Without a cumbersome bureaucratic machine, a measure of borrowing and lending activities must be left outside the scope of the controls, with the consequential possibility of evasion by certain types of enterprise. Where some interest rates are left free while others are pegged, it may be difficult for those subject to rate fixation to attract funds.

177. An attempt to abolish interest altogether would create an almost insatiable demand for credit, while substantially reducing the supply of money available for borrowing; in these circumstances it is hard to see any alternative to complete control by the State of the allocation of loan moneys. Taxation would be necessary to provide an adequate supply and some authority would have to decide which of the many applicants for loans would be granted loans.

178. Thus, attempts to abolish interest would, in the view of the Commission, prove disastrous and attempts to hold interest rates excessively low are fraught with difficulty. The crux of the matter is that loan money, like goods and services, is scarce in relation to the amounts which people would like to have. It is necessary, therefore, to apportion the available supply in some way. This can be done either by charging a price for it, thus discouraging some of the potential demand, or by allocation by some authority. There are occasions, as in the case of goods and services, when direct controls over interest rates and demands for credit are desirable to prevent spectacular rises which might occur due to a temporary scarcity of loan money. Control of interest rates may also be necessary as part of an overall stabilisation policy in times of emergency. But, as a general rule, the Commission believes that it is desirable to allow the apportioning to be done through the price mechanism.

179. It may be objected that, since large firms and wealthy people can afford to pay a higher price than small firms and poorer people, such a policy is inequitable. But we believe that, if it is considered at any time that the distribution of income is inequitable, it is better to correct it by taxing those with high incomes and giving to those with less, rather than to interfere arbitrarily with competitive loan or other market transactions, especially when such interference can, at best, have only limited success in achieving its objective.

Conclusion

180. To sum up: Our credit or debt system performs the following useful functions:

(a) It provides, without excessive inflation of the money supply, a means of calling forth the funds required for modern production and of apportioning the available supply of loan money without undue intervention by the State.

(b) It enables those who wish to save money for various reasons to earn an income from their savings without investing them directly in property or business.

(c) The specialist financial intermediaries in the credit market aggregate small savings into amounts large enough to be of use in production; they develop experience in assessing the credit worthiness of applicants for loans; and they reduce the cost of marketing credit below that which would rule if people had to find outlets for their own funds.

(d) The system enables private firms and individuals to obtain control of the expensive fixed and working capital necessary for efficient production; it enables families to obtain houses, home utilities, and ancillary services (through their local governments) earlier in life than if they had to provide them completely from their own resources.

181. A society without debt and interest would be inconsistent with the institutions of private ownership and enterprise, for the funds for capital expenditure would inevitably have to be collected and allocated by the State.

II. THE MAJOR BORROWERS IN THE NEW ZEALAND CREDIT SYSTEM

The Central Government

182. Government borrowing has always been important in the credit market in New Zealand and the Government has considerably increased its nominal indebtedness during the period under review in this report. Table A on page 287 indicates the changes which have taken place in the New Zealand public debt, both internal and overseas, and of the sources of the funds which have been raised.

183. It will be seen that the public debt increased from £313 million to £731 million between March 1934 and March 1955. However, these figures obscure an important change in the domicile of the debt. The overseas debt of the Government fell during the period from £174 million to £100 million due primarily to the repayment of nearly £50 million during the year ended 31 March 1946, while its internal debt rose from £139 million to £631 million. Overseas debt, therefore, comprised only about 14 per cent of the total in 1955 as compared with 56 per cent in 1934. As a result of this, and of some reduction in interest rates, the annual interest payments which the Government made overseas fell from £6·1 million in 1933–34 to £2·8 million in 1954–55. As a percentage of the country's export income, the overseas interest payments fell from 13·3 per cent to 1·1 per cent in the same period.

184. Moreover, the rise in the total nominal debt and the interest paid on it must be considered in relation to the increase in the national income which has occurred since 1934. The gross national income in 1933–34 is estimated to have been £127 million; in 1954–55 it was £927 million. Thus the Government's debt was equivalent to only 79 per cent of the gross national income in 1955, as compared with 246 per cent in 1934.

185. Table B on page 287 shows the amounts of interest paid on the public debt in the years concerned and their relationship to the gross national income and to the total taxation collected by the Government.

TABLE A—Investments in Government Securities (Stock and Treasury Bills) as at 31 March
(£ million)

—	1934	1939	1946	1950	1955
1. Post Office Savings Bank(¹) ..	41·5	51·3	143·3	136·7	118·1
1A. Post Office Savings Bank (including S.A.C. securities) ..	41·5	57·0	145·2	168·9	214·9
2. National savings	..	..	35·0	45·7	63·5
3. Trustee savings banks ..	2·7	3·8	20·7	29·9	28·1
4. Insurance companies(²) ..	15·0	15·6	38·8	51·7	56·6
5. Government superannuation ..	0·7	1·5	2·2	5·7	15·8
6. National Provident(²) ..	1·9	3·7	6·9	8·9	5·4
7. Earthquake and war damage ..	..	..	4·7	6·7	12·1
8. Reserve Bank	..	14·5	45·6	91·0	60·4
9. Trading banks(¹)	23·5	10·1	26·8	11·7	11·8
10. Meat Industry Account ..	..	..	8·0	27·5	38·6
11. Dairy Industry Account ..	..	..	6·2	14·2	14·4
12. Wool Commission	..	..	..	13·0	25·7
13. Other Government accounts (within Public Account, Maori Trustee, Marketing, Broadcasting, etc.) ..	..	..	14·5	30·2	51·4
14. State Advances Corporation ..	..	..	3·0	1·0	2·3
15. Public Trustee	2·9	4·1	7·8	4·4	4·6
	88·2	104·6	363·5	478·3	508·8
Other public holdings ..	50·8	41·6	109·2	86·8	122·0
Total holdings of government securities domiciled in New Zealand(¹) ..	139·0	146·2	472·7	565·1	630·8
Overseas Debt of New Zealand Government	173·9	166·8	121·6	80·9	99·9
Total indebtedness(¹) ..	312·9	313·1	594·4	646·0	730·7
Percentage of other public holdings to total holdings in New Zealand ..	36·5%	28·5%	23·1%	15·2%	19·3%
Percentage of overseas debt to total indebtedness	55·6%	53·3%	20·5%	12·5%	13·7%

(¹) Excludes State Advances Corporation securities.
(²) Figures for previous December.

TABLE B—Interest Paid on General Government Debt Compared With Gross National Income and Total Taxation
(£(N.Z.)million)

—	Year Ended March				
	1934	1939	1946	1950	1955
Interest paid overseas	6·1	6·8	7·1	2·8	2·8
Interest paid in New Zealand ..	5·6	4·7	11·5	13·9	17·2
Total	11·7	11·5	18·6	16·7	20·0
Total interest paid as—					
(a) Percentage of gross national income	9·2%	5·0%	4·7%	3·0%	2·2%
(b) Percentage of total tax collected	54·5%	30·4%	16·2%	12·3%	8·5%

It can be seen that, although the amount of interest paid has risen considerably in money terms, it has declined markedly in relation to the gross national income and to total taxation.

186. Table A on page 287 gives a broad indication of the sources of the funds which the Government has borrowed. The most striking feature of the table is the large proportion of the Government's debt which is held by the Post Office Savings Bank. Its importance as a source of funds for the Government becomes even more striking if account is taken of borrowing by the State Advances Corporation, which is not included in the public debt figures, except in so far as money has been allocated to the Corporation from general Government loan funds for investment in State housing, rehabilitation loans, etc. The figures in Item 1A indicate the amounts lent by the Post Office to both the Government and the Corporation. Since the total of stock and debentures of the Corporation outstanding at 31 March 1955 was £114 million, it is obvious that the Post Office Savings Bank is by far its greatest creditor, holding in the region of £97 million worth of State Advances Corporation securities. The bulk of the remainder of the Corporation's stock is held by the trading banks.

187. During and since the war, the Government has also borrowed large additional amounts from national savings and up till 1950 from the trustee savings banks. At the end of March 1955 it was indebted to "small savers", through the savings institutions we have mentioned, to the extent of about £210 million (or about £307 million if the State Advances Corporation's debt is included).

188. The next important group of institutions from which the Government has borrowed is that which assists the people to make provision for their old age or to cover the risks of death, accident, and so on. At the end of March 1955 the Government was indebted to insurance companies, its own superannuation funds, the National Provident Fund, and the Earthquake and War Damage Fund to the extent of nearly £90 million.

189. The banking system is the source of most of the Government's short-term borrowing in anticipation of revenue. It has also been an important provider of long-term credit. Changes in Government indebtedness to the banking system have been discussed fully in paragraphs 91 to 105 above. The main point to note here is that the trading banks hold only a small proportion of the public debt domiciled in New Zealand – under 4 per cent, even if account is taken of their holdings of State Advances Corporation stock. Further, the greater proportion of this debt is held by the State-owned Bank of New Zealand.

190. Other important sources of Government finance during the war, and up till about 1953, were the various funds, set up primarily under the stabilisation agreement examined elsewhere, to accumulate reserves for the benefit of the primary industries. The necessity to seek loan money from the general public was substantially reduced during the early post-war period due to the availability of finance from these funds; this is undoubtedly a major factor in explaining the fall in "other public holdings" between 1946 and 1950. Since it was decided about 1952 virtually to cease the further accumulation of reserves in these funds,

the Government has become much more dependent on the general public for its requirements. As at 31 March 1955, the Meat Industry Account, the Dairy Industry Account, and the Wool Commission together held Government securities of a nominal value of £79 million.

191. In March 1955, £51 million of the securities domiciled within New Zealand were held by various Government Departments. This represented, in the main, the temporary investment by these Departments of cash balances received from various sources which they found it impossible or unnecessary to spend in other ways. Virtually, then, this part of the public debt is owed by one Government account to another.

192. Minor amounts have been obtained from investment of trust moneys, etc., by the Public Trustee, and from the investment of the General Reserve Fund of the State Advances Corporation.

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

194. Although the allocation to particular purposes of the sums borrowed by the State is to some extent arbitrary, an idea of the uses to which the funds have been put may be gained from the following table taken from the 1955 Financial Statement by the Minister of Finance:

Allocation of the Public Debt as at 31 March 1955 According to the Expenditure Appearing in the Departmental Accounts

		£ thousands
Bank of New Zealand (shares)		7,709
British Petroleum Co. of New Zealand Ltd.		1,275
Christmas Island phosphates		1,389
Education buildings		19,600
Forests (State)		11,770
Harbours and lighthouses		400
Housing		89,163
Hydro-electric schemes		99,695
Land settlement and improvement		33,252
Mining		7,136
Murupara development		3,779
National development loans		7,191
New Zealand National Airways Corporation		1,200
New Zealand Woolpack and Textiles Ltd.		150
Post and Telegraph services		42,675
Public buildings		3,189
Railways—	£	
Capital	103,554	
Lines under construction	6,914	
		110,468
Reserve Bank exchange adjustment		20,000
Roads and highways		55,620
Soil conservation, irrigation, and drainage		10,918
Tasman Empire Airways Ltd.		811
Tasman Pulp and Paper Co. Ltd.		8,400
War expenses (1939–45)		188,485
Miscellaneous assets and services		2,156
Cash and investments in hand		4,253
		£730,684

195. A large part of the public debt has been invested in undertakings which return considerable revenues to the State as well as assisting in the development of the nation's industry and commerce. The interest and profits received by the State in 1954–55 from public enterprises in which money received from borrowing is invested amounted to £11·4 million. The Government's interest and management charges in the same year were £21 million, so that about 55 per cent of the interest and management cost was recovered from the investments.

196. Although the money borrowed by the Government and spent on roads and bridges, on schools, and on other forms of social capital does not return monetary profits, it is productive.

Local Bodies

197. New Zealand's development and growth of its population require an increasing supply of basic local services such as water supply, sewerage, and street improvements, and the improvement and expansion of hospital services, transport facilities, and electric power. Local bodies play an important part in providing these services and must necessarily borrow from time to time to meet the heavy capital costs involved.

198. The following table indicates the changes which have taken place in the total gross indebtedness of local bodies since 1934, the relative proportions of their debt held in New Zealand and overseas, and the major sources of the money borrowed:

Investments in Local Bodies' Securities

(£ million)

—	As at 31 March				
	1934	1939	1946	1950	1955
Post Office Savings Bank	0·4	0·6	0·4	0·3	0·2
Government Superannuation Funds	0·8	1·1	0·9	0·6	0·4
National Provident([1])	0·2	0·5	0·4	1·1	9·1
Public Trustee	7·9	6·8	5·8	4·8	3·2
State Advances	4·6	6·2	5·4	5·5	6·4
Other Government Accounts	0·1	0·3	0·2	1·0	0·9
Maori Trustee	..	..	..	..	0·1
Trading banks	0·2	0·3	2·4	1·7	2·1
Trustee savings banks	1·9	2·5	2·6	2·5	5·3
Insurance companies([1])	16·3	19·9	23·3	25·7	32·6
	32·4	38·2	41·4	43·2	60·3
Other public holdings	20·0	17·2	15·2	13·2	26·3
Total holdings of local bodies' securities domiciled in New Zealand	52·4	55·4	56·6	56·4	86·6
Overseas indebtedness of local bodies	25·1	18·0	9·4	5·3	4·0
Total indebtedness of local bodies	77·6	73·4	66·0	61·7	90·5
Percentage of other public holdings to total holdings in New Zealand	38·2%	31·0%	26·9%	23·4%	30·4%
Percentage of overseas to total indebtedness	32·3%	24·5%	14·2%	8·6%	4·4%

([1]) Figure for previous December.

199. It will be noted that the total indebtedness of local bodies showed a gradually declining trend from 1934 till 1950, the only interruption to the trend being a slight rise in indebtedness between 1938 and 1940. As a consequence, total indebtedness in 1950 was nearly £16 million less than in 1934. Since 1950 local body debt has increased at an accelerating rate, passing the 1934 figure in 1954 and reaching £90·5 million at 31 March 1955.

200. A notable fact shown by the above table is the decline in the overseas indebtedness of local bodies. It has apparently been a matter of Government policy to discourage borrowing overseas by local bodies. Many local bodies themselves would in any case be reluctant to take the risks involved in the possibility of a depreciation of the exchange rate, which if it occurred would increase their annual interest payments in terms of New Zealand currency. Local body debt held overseas was over £21 million less in 1955 than in 1934, and represented only 4·4 per cent of total indebtedness as compared with 32·3 per cent in 1934.

201. The following table indicates that, despite the recent rise in indebtedness, local bodies have to devote a much lower proportion of their total revenue to interest payments than they did before the war:

Interest Charges on Loans and Overdraft as a Percentage of Total Revenue

—	Total Revenue	Interest on Loans and Overdrafts	Percentage of Interest to Total Revenue
	£ million	£ million	
1934	14·2	3·5	24·6
1939	18·7	3·0	16·0
1946	24·5	2·5	10·2
1950	32·7	2·3	7·0
1953	44·1	2·3	5·2
1955	57·3	2·9	5·1

NOTE.—This table does not cover the operations of hospital boards.

202. A number of factors are responsible for the fall in local body indebtedness between 1934 and 1950. Among them are:

(a) Shortages of labour and materials preventing any major expansion of works projects.

(b) The policy adopted, under the guidance of the Local Government Loans Board, of making provision for repayment of loans within a reasonable period related to the life of the assets provided from the loans.

(c) A tendency for many local bodies to meet a substantial part of the cost of works from current revenue.

(d) The transfer to general Government taxation of certain local body costs, especially the cost of hospital works.

203. Since 1950 the rapid population increase, the expansion of housing construction (especially on the outskirts of the main cities), and a somewhat increased supply of more costly labour and materials has led to a sharp increase in local body expenditure on the extension of the facilities which they provide, necessitating greater recourse to loan finance.

204. Some indication of the magnitude of the increase in the demand for loan money by local bodies in the past few years is given in the following table, showing applications to the Local Government Loans Board for approval to raise loans:

Year Ended 31 March	Total New Applications
	£
1946	3,497,820
1947	9,843,543
1948	8,324,579
1949	8,934,705
1950	8,062,758
1951	10,825,192
1952	15,092,761
1953	29,129,996
1954	24,908,485
1955	28,586,666

205. An indication of the purposes for which loans have been sought and sanctioned is given below:

Details of New Loans Sanctioned by the Local Government Loans Board from 1 April 1951 to 31 March 1955

March Year	1951–52	1952–53	1953–54	1954–55
	£	£	£	£
Waterworks	820,650	1,633,820	1,352,830	4,050,820
Drainage and sewerage	109,300	1,298,875	4,471,935	6,409,405
Roads, streets, and bridges	1,146,980	2,638,885	1,378,000	2,577,340
Public buildings	93,550	642,425	624,000	572,750
Public transport	2,476,000	7,000	850,200	2,723,200
Recreational facilities	270,050	276,890	58,800	408,950
Housing	601,757	496,920	561,200	1,526,800
Electricity supply	2,502,050	2,498,600	2,471,500	2,962,150
Hospital works	1,991,500	2,192,550	4,047,200	2,204,500
Harbour works	2,876,100	5,061,500	1,448,000	1,074,340
Fire services	52,915	273,740	221,905	216,830
Gasworks	157,400	94,970	196,500	279,650
Abattoirs	54,600	2,500	23,300	33,000
Machinery	82,495	37,410	89,650	124,920
River works and flood damage	27,250	219,900	405,590	68,600
Auckland Harbour Bridge	..	..	5,002,000	..
Miscellaneous	628,700	477,575	780,200	585,700
	13,891,297	17,853,560	23,982,810	25,818,955

206. Recurrent difficulties have faced local bodies since 1951 in raising the finance which they require to carry out works. The smaller local bodies have had particular difficulty, and special problems have arisen in the Auckland urban area, where the demand for loan money has been very heavy.

207. According to the Loans Board, until towards the end of 1951 local bodies had for many years been able to get their loan finance in the main from institutions – particularly from the insurance companies, but also from the State lending institutions, the trustee savings banks, etc. –

all of which were prepared to invest substantially in local body debentures. Some local bodies elected to borrow by selling debentures of small denominations to the general public and they did so without great selling expense. Before 1951 (and indeed well back into the pre-war years) local bodies were able to borrow the moneys needed to finance their capital works programmes without any difficulty, except for a short period about the beginning of the last war. However, 1951 saw a gradual tightening of the loan market arising from increasing demand, and local bodies experienced corresponding difficulty in obtaining their requirements. Indeed, in the early part of 1952, a virtual stalemate was reached.

208. The rate of interest which local bodies were permitted to offer was raised in August 1952, but apart from a short period in late 1953 and early 1954, when there was a temporary easing of the demand for credit by the private sector, local bodies have continued to find the market for their securities difficult. For instance, the following table shows that, despite an increase in the amounts approved by the Local Government Loans Board, the total of loan moneys actually raised declined in 1954–55:

(£ million)

—	Loan Moneys Raised	Loans Sanctioned	
		Works	Redemptions
1952–53	11·6	17·9	0·2
1953–54	16·6	24·0	0·3
1954–55	15·4(1)	25·8	0·4

(1) Provisional

209. To help to meet the position, the Board in 1955 authorised the reintroduction of the practice of underwriting local body loans, the fee permitted being 10s. per cent. The maximum rate of interest was also raised again in October 1955.

210. The main reason for the difficulties faced by the local bodies appear to be that increases in interest rates approved for local body loans have not been in line with increased returns available from other avenues of investment. As a consequence, local bodies have not obtained as much as they would have wished from some of the institutions to which they have traditionally looked for funds. For instance, although insurance companies, the main source of local body finance, increased their holdings of local body securities by about £7 million between 1950 and 1955, they increased their holdings of mortgages by nearly £40 million. Before the war, insurance companies' holdings of local body securities were about double their holdings of mortgages – but, in 1955, their holdings of mortgages were nearly £25 million greater than their holdings of local body securities. The Public Trustee has also preferred mortgages to local authority debentures since 1950 and has actually reduced his holdings of the latter.

211. The Government has attempted to alleviate the position by making more funds available to the local bodies through the National Provident Fund and the State Advances Corporation, and the trustee savings banks

have increased their holdings by nearly £3 million since 1950. But, in general, it is clear that the terms of local body loans have been insufficiently attractive to institutional investors.

212. As a consequence, local bodies have had to rely heavily on private investors for their requirements. This is indicated by the following table showing sources of funds borrowed by local bodies during the year ended 31 March 1955 under some of the loan authorities issued during that year:

	£
Private investors([1])	5,552,320
Insurance and trust companies([2])	1,234,895
National Provident Fund	747,200
State Advances Corporation	273,040
Other companies	167,200
Other local authority funds([3])	120,000
Other sources	104,950
	£8,199,605

([1]) Includes some public issues which do not show the various sources of the moneys and may include some investments by companies, etc.

([2]) Includes insurance companies, savings banks, trustee companies, building societies, and trading-bank investments.

([3]) Sinking funds, depreciation funds, etc., of other local authorities.

213. The foregoing statistics cover only a little over half the full amount borrowed by local bodies during the year, but they are sufficiently comprehensive to indicate the relative importance of the various sources contributing to local body loans at the time.

214. To attract the small investor in a period of inflation, local bodies have found it necessary to offer debentures covering a much shorter term than they have been accustomed to offer in the past. This, of course, will involve them in arranging for refinance of many loans at comparatively short intervals.

215. Two other, relatively minor, sources of loan finance for local bodies should be mentioned. Firstly, there has been some pooling of temporary surplus loan moneys. In November 1955 the Government announced that the Investment Committee established to control the National Provident Board's funds would also be authorised to control a pool of local body funds that could be lent to other local bodies. This proposal apparently replaces and extends the previous activities of a private sharebroker who had been of "considerable assistance", according to the Secretary to the Treasury, in carrying out a limited function of this nature.

216. Secondly, local bodies with rating powers may borrow within limits on overdraft, and in March 1955 their indebtedness in this form was £1·5 million.

Private Borrowing

217. It is impossible, without a great deal more information than is at present available, to provide an adequate account of the structure of private indebtedness in New Zealand, or to trace the changes which have taken place since 1934. We make suggestions in our report as to statistics which might be collected and research which might be done in this field. In this appendix we can do no more than give some indication of the trend of private indebtedness and discuss briefly some of the problems which have arisen or persisted during the period under review.

218. Probably the best indication of the general trend of private indebtedness during the period is given by the following figures of loans made by various financial institutions:

Loans of Various Financial Institutions to the Private Sector

(£ million)

—	As at 31 March				
	1934	1939	1946	1950	1955
State Advances Corporation mortgages and industrial loans	42·5	51·6	47·4	75·0	117·6
Insurance companies—					
Mortgages(1)	8·2	11·6	12·5	18·7	58·1
Loans on policies(1)	6·0	5·5	3·8	3·6	4·2
Public Trust Office mortgages ..	13·2	11·8	9·8	9·1	13·4
Building societies: Loans	8(2)	10(2)	12·1	16·3	26·6
Trustee savings banks mortgages ..	5·9	7·0	6·8	8·1	13·6
Government Superannuation Funds: Mortages	3·2	2·6	1·9	0·8	0·4
National Provident Fund: Mortgages(1)	1·3	1·1	0·8	0·7	1·0
Trading-bank advances and discounts(3)	41(2)	55·5	58·0	96·1	189·3
	129(2)	157(2)	153·1	228·4	424·2

(1) End of previous December.
(2) Approximately.
(3) Last balance day in March.

219. It should be stressed that this is by no means a complete coverage of private borrowing (e.g., it excludes sales on credit terms by all types of business and loans by a number of financial institutions (mostly small) and by individuals or firms). But the table gives a fair indication of the general trend of private borrowing.

220. It will be noted that, as the country emerged from the depression between 1934 and 1939, private indebtedness to the institutions covered by the table rose by between a fifth and a quarter. There were two major causes of the rise:

(a) The community became increasingly indebted to the trading banks as the level of economic activity increased, making it necessary for firms to increase their working capital; and

(b) The better economic conditions led to a greater demand for housing and farm properties, necessitating greater recourse to institutions providing mortgage finance.

221. During the war, loans of the institutions covered in the table to the private sector declined slightly, increased loans to some people and firms being more than offset by repayments by others. Shortages of labour and materials and various controls restricted private expenditure, and surplus funds were directed primarily to the Government for war purposes.

222. Between 1946 and 1950, with expansion of business, settlement of servicemen on farms, and a greatly increased demand for housing, private indebtedness to these institutions rose by about 50 per cent. But a more spectacular rise of about 86 per cent occurred between 1950 and 1955, when loans of these institutions increased from £228 to £424 million. A major influence here was a sharp rise in prices of land and property, as controls on their sale were lifted under prevailing conditions of inflation and rising population. Moreover, despite higher costs, farmers and business firms were anxious to expand their assets to take advantage of the sellers' market which has persisted, with occasional minor set backs, up till the time of writing.

223. Private borrowers may be classified into four main groups, viz. (a) industry and commerce, (b) farmers, (c) individuals requiring finance for housing, and (d) individuals requiring finance for various consumer goods. It is proposed briefly to comment on borrowing and the sources of loan money for each of these groups.

Industry and Commerce

224. A new firm starting business or a firm which requires money to expand its plant or equipment or to maintain or expand its stocks has several alternatives open to it. It may obtain long-term finance:

(a) By selling ordinary or preference shares to existing owners or to outsiders.
(b) By retaining in the business sums which it could otherwise pay as dividends to shareholders.
(c) By issuing mortgages and debentures as security for loans by individuals or financial institutions.

It may obtain short-term finance:

(a) By obtaining loans on overdraft from a trading bank.
(b) By arranging loans from its suppliers or customers or by deferring payment of its suppliers' accounts.
(c) By accepting deposits from customers.
(d) By deferring payment of its taxes (and thus incurring the penalty involved).

225. It is impossible to determine how New Zealand business firms have financed their expansion in recent years, but the following information may be helpful as a background to discussion of the problems of providing adequate industrial and commercial finance in this country.

226. A striking characteristic of New Zealand business is the small size of the average business unit and the relative importance of private companies and individually-owned enterprises as units of business organisation. For instance, in 1952–53 only about 10 per cent of the factories and 3 per cent of the retail stores were operated by registered public companies. The small size of the average New Zealand factory is indicated by the following figures:

Averages of Factory Statistics, 1953–54

	Average Per Establishment
Persons engaged	17
Added value	£19,317
Value of premises and plant—	
Land and buildings	£8,349
Plant and machinery	£6,286
Capital Expenditure during year 1953–54 ..	£2,289

227. Even in terms of nominal and paid-up capital, the private companies as a group have, due to their increasing numbers, been overtaking the public companies, as the following table shows:

(£ million)

—	Private Companies			Public Companies		
	Number	Nominal Capital	Paid-up Capital	Number	Nominal Capital	Paid-up Capital
1932	6,083	48·4	(1)	1,732	97·6	59·1
1938	7,399	55·8	49·3	1,626	100·2	64·9
1947	11,358	87·0	77·8	1,381	106·4	73·2

(1) Not available.

228. Although no statistics are available to show how the individually owned enterprises and private companies have financed their expansion in recent years, it is generally agreed that they have relied fairly heavily on retained profits and on short-term finance, especially on bank overdrafts, not only for working capital, but also for purchase of plant and equipment. They have been fortunate in facing a sellers' market which has enabled them to "plough back" substantial sums into the business, but it has proved difficult for small firms to secure long-term finance from other sources.

229. Small firms cannot issue shares to the public through the Stock Exchange and must rely for borrowed funds on private individuals or firms, or on financial institutions. There has been an increasing tendency for life insurance companies to turn to commercial and industrial mortgages as an avenue of investment in the last few years. One company, holding about 45 per cent of the total mortgages held by life insurance companies in December 1954, had commercial and industrial mortgages totalling nearly £10 million at that date. Finance companies also provide a certain amount of capital, mainly for a medium term. We have no information on the proportion of the funds advanced by these institutions which has been made available to smaller concerns.

230. Some information is available on the finances of public companies as a result of a survey by the Reserve Bank of the accounts of 203 public companies for the years ending June 1953 and 1954. The following table prepared from information supplied by the Reserve Bank compares the structure of their liabilities and assets with those of companies surveyed in a few other countries:

Comparison of Company Financial Statement Structure Between New Zealand and Other Countries

	New Zealand		United Kingdom		Canada	Sweden	India
	1953	1954	1953	1954	1953	1953	1951
LIABILITIES							
	Per Cent	Per Cent	Per Cent	Per Cent	Per Cent	Per Cent	Per Cent
Bank overdrafts and loans ..	12·81	10·26	4·69	4·81	4·20		21·89
Creditors, etc.	16·61	17·55	22·66	22·04	10·67	25·48	11·43
Future taxation	3·91	3·69	5·78	5·79	3·68		7·34
Current liabilities (total) ..	33·33	31·50	33·13	32·64	18·55	25·48	40·66
Debentures and mortgages ..	10·80	11·45	11·37	11·54	17·98	22·14	3·98
Outside interest in subsidiaries	0·67	0·62	1·76	1·66	..	..	..
Long-term liabilities (total) ..	11·47	12·07	13·13	13·20	17·98	22·14	3·98
Preference capital.. ..	5·69	5·73	9·33	8·77	5·34		34·92
Ordinary capital ..	30·59	30·96	19·74	20·07	22·72		
Capital reserves	2·29	1·88	7·19	6·63		52·38	
Revenue reserves and carried forward	16·63	17·86	17·49	18·70	35·41		20·45
Shareholders Funds (total)	55·20	56·43	53·75	54·17	63·47	52·38	55·37
Total liabilities ..	100	100	100	100	100	100	100
ASSETS							
Cash, etc.	1·06	1·47	9·28	10·39	5·11	32·73	6·29
Debtors	15·75	16·52	16·62	17·07	12·46		21·78
Stocks	29·45	25·61	28·90	27·56	23·57	16·64	34·58
Current assets (total) ..	46·26	43·60	54·80	55·02	41·14	32·73	62·65
Total Investments	17·73	19·31	13·67	12·50	11·35	..	6·01
Fixed Assets: Land, property, and plant	36·01	37·09	31·53	32·48	47·52	50·63	31·35
Total assets	100	100	100	100	100	100	100

Sources:
United Kingdom: Economist; statistics of 537 companies.
Australia: Australian Financial Review; statistics of 373 companies.
Canada: Bank of Canada Bulletin; statistics of 704 companies.
Sweden: Skandinaviska Banken; statistics of about 70 large companies.
India: Reserve Bank of India; statistics of 757 companies.
New Zealand: Reserve Bank of New Zealand; statistics of 203 public companies.

231. The Reserve Bank in submitting the above table made the following comments:

The figures are not absolutely comparable for the following reasons. There are substantial differences in economic and financial policy and structure of the countries concerned which naturally have a bearing on the type of industry carried on and in the analysis of company balance sheets generally. Although the number of companies making up each country survey is given, the methods of compilation are not known in all cases nor do we know how representative a sample each overseas company analysis comprises. The New Zealand statistics probably show a slightly better financial position than is the overall general company situation. No private companies are included in the survey and nearly 90 per cent of New Zealand companies are private concerns, the majority of which are relatively small.

232. The Reserve Bank also supplied the following interpretation of the data in the table:

(1) The predominant differences in the figures submitted show that companies in overseas countries, with the exception of India, rely less on bank overdraft and other short-term borrowing than New Zealand companies. They do, however, use long-term mortgage and debenture capital and retained profit reserves more.
(2) The more fully developed capital market in overseas countries probably explains the higher percentage of capital funds obtained from long-term borrowed money against fixed asset holdings in the case of all overseas countries shown excepting India.

(3) The higher percentage of funds obtained through sundry short-term creditors in the United Kingdom, compared with that for other countries shown, is offset by higher percentage figures in cash balances and in debtors.

(4) United Kingdom firms appear to have a higher turnover and stock-turn on approximately the same shareholders' funds percentage figure as other countries in the survey. Because of higher business activity greater liquid balances are required.

(5) In spite of the higher stock-turn figures, net profit after tax is a lower percentage of shareholders' funds in the United Kingdom than in the other countries surveyed. This is probably explained by the profit mark-up being lower through competition or because higher percentage taxes take more of profit than in other countries.

(6) The better working capital position of companies in all the overseas countries surveyed, except Sweden, is particularly noticeable.

(7) The break-up of shareholders' funds, particularly the high proportion held by New Zealand companies in ordinary shares and the lower percentage owned in preference capital and reserves is probably explained by the fact that in other countries industries have been longer established thus enabling the building up of reserves and with the addition of an unpegged interest rate making preference shares more attractive to the cautious investor.

(8) The proportion of funds held in stocks amongst the countries calls for little comment except in the case of Sweden where the figure is very low perhaps because of the nature of many of the companies included in their survey, all of which are large firms. For example, pulp and paper companies appear to carry only a small proportion of their assets in the form of stocks, whilst a high percentage is tied up in fixed assets as is the case with most firms in heavy industry.

(9) The generally higher percentage of funds held in the form of fixed assets in the countries other than New Zealand and the United Kingdom may be due to the fact that, in our own case, secondary industry is predominantly light industry. A possible explanation for the United Kingdom's low fixed assets percentage figure may be fairly extensive use of the method known as "sale and lease back" where large firms sell their land and buildings to big financial institutions which in turn grant long-term leases to the vendor company. In addition, the tremendous spurt in the consumer goods industries since the war in the United Kingdom will have caused a reduction in the fixed asset percentage figure. A higher stock-turn figure reinforces this argument.

233. Some companies operating in New Zealand have overseas affiliations and receive financial assistance from them. The assistance may take the form of remittances of cash, or the provision of capital assets without corresponding payment, or the reinvestment of profits earned in New Zealand by overseas companies. The Department of Statistics has, since 1950, undertaken an annual survey of companies with overseas affiliations, from which were obtained the following figures of annual increases of investment capital in New Zealand branches and subsidiaries of overseas companies:

Overseas Private Direct Investment in New Zealand

(£ million)

——	1950–51	1951–52	1952–53	1953–54	1954–55
Increases in Investment (1)	6·7	12·4	9·7	1·6	11·4

(1) Includes: (a) Remittances of cash to New Zealand; (b) imports into New Zealand of plant and machinery and commercial stock not paid for by the New Zealand affiliate; (c) dividends declared but not remitted to Head Office; (d) profits retained in New Zealand.

Borrowing by Farmers

234. Especially from 1950 onwards, the demand for farm property has been very high, and farm properties have changed hands at greatly increased prices. This has led to an increasing demand for mortgage finance by potential farmers, as indicated by the following figures:

Mortgages Registered on Country Properties

Year Ended 31 March	Amount Secured on Mortgages Registered During Year
1934	3·8
1939	8·6
1946	8·5
1950	13·4
1954	28·6

235. The main institutional sources of mortgage finance for farm properties have been the State Advances Corporation, the insurance companies, and the Public Trust Office. The following table shows changes in the rural mortgages held by the State Advances Corporation and the Public Trustee and by the largest life insurance company in New Zealand in four years since 1939:

Holdings of Rural Mortgages

(£ million)

As at 31 March	State Advances Corporation	Public Trust Office	A.M.P. Society
1939	25·5	(1)	3·2(2)
1946	23·6	(1)	3·3(2)
1950	36·6	7·0	3·8(2)
1955	50·5	6·8	8·7(3)

(1) Not available
(2) Figures for 31 December
(3) December 1954

236. The mortgages of the State Advances Corporation include loans made to ex-servicemen at low rates of interest under the Rehabilitation Act. Of course, a large number of mortgages would be negotiated privately or through solicitors, but no figures are available to show the holdings of these. Farm mortgages are an important aspect of the business of the Invercargill Savings Bank – their holdings were £988,000 as at 31 March 1955.

237. For short-term finance, farmers rely heavily on the trading banks and on stock and station agency firms. The following figures show advances by trading banks to farmers as at the end of March of the years concerned:

Trading-banks' Advances to Farmers

End of March—	£ million	End of March—	£ million
1939	18·5	1954	24·6
1946	19·3	1955	29·3
1950	17·3		

238. Particulars of advances to farmers by stock and station agency firms are not available, but the Secretary of their Association estimated, in evidence before the Commission, that they would be not less than £20 million at that time.

Finance for Housing

239. The value of dwellings erected annually in New Zealand has risen from £1·3 million in 1933 to £7·5 million in 1939, £20·8 million in 1950, and £40·2 million in 1955. This expansion of the value of buildings constructed, in conjunction with an increasingly rapid transfer of existing properties at rising prices, has led to a marked increase in the demand for mortgage finance for the erection or purchase of dwellings.

240. The following table shows the residential mortgages held by the major institutions providing such finance at various dates during the period under review:

Investments of Various Institutions in Residential Mortgages

(£ million)

—	As at 31 March				
	1934	1939	1946	1950	1955
State Advances Corporation: Urban mortgages(1)	(2)	26·1	23·8	38·4	65·6
Building societies: Loans	8(3)	10(3)	12·1	16·3	26·6
Trustee savings banks: Mortgages(4)	5·9	7·0	6·8	8·1	13·6
Public Trustee mortgages on dwellings or flats	(2)	(2)	(2)	3·8(3)	4·2
A.M.P. Society, city and suburban properties(5)	(2)	1·0(6)	1·4(6)	5·9(6)	17·0(7)

(1) Figures for 1939, 1946, and 1950 include industrial loans, probably of between £1 million to £1½ million.
(2) Not available.
(3) Approximate only.
(4) Includes some farm mortgages, probably not exceeding £1½ million in 1955.
(5) Includes commercial and industrial mortgages, which would be an increasing proportion of the total at later dates. As at 31 December 1954, residential mortgages were £7 million and industrial and commercial mortgages £10 million.
(6) Figures for 31 December of year concerned.
(7) As at 31 December 1954.

241. A number of other institutions provide mortgage finance for housing (e.g., the other insurance companies and various investment or trust companies) and a considerable amount would probably be arranged privately or through solicitors, but details of amounts lent in these ways are not available. Trading-bank advances for housing purposes (including group housing) were £10·3 million at the end of December 1954 and £7·3 million at the end of December 1955.

242. The State has placed major emphasis on housing and housing construction throughout the whole period under review and, as one aspect of this policy, has taken special steps to make large amounts of loan money available at relatively low rates of interest. The number of loans authorised by the State Advances Corporation on urban mortgages between March 1935 and March 1955 was 89,100, to a total value of £116 million.

243. As a matter of Government policy, two groups have received especially favourable treatment in obtaining loans from the Corporation:

(a) Under the Rehabilitation Act 1941 and its amendments, over 49,000 housing loans totalling £67 million had been made to ex-servicemen and ex-servicewomen up to 31 March 1955, mainly at a rate of interest of 3 per cent (while, incidentally, £5·7 million had also been lent to such persons interest free for the purchase of furniture).

(b) The other group receiving specially favourable treatment has been tenants of State rental houses, who were offered the houses for purchase on generous terms from 1950 onwards. The price of the houses was fixed on the basis of their cost of construction, which in the majority of cases would be well below current costs and market values; for houses built before 1950 a deposit of only 5 per cent of the purchase price was required; a suspensory loan of up to 10 per cent of the purchase price was granted and the balance was payable over terms of up to forty years at a rate of interest of 3 per cent. We were informed by the General Manager of the State Advances Corporation that the sale of these houses, even on these terms, had had a favourable effect on the finances of housing administration as it reduced the annual loss involved in the letting of State houses at low rentals. The accumulated loss up to 31 March 1955 in the revenue account of the Housing Account administered by the Corporation was about £1,166,000. Even in 1955, the current annual deficiency in respect of State rental units was estimated at about £300,000.

244. Loans to persons not eligible for rehabilitation assistance were provided mainly at a rate of $4\frac{1}{8}$ per cent, except in the case of loans for the purchase of existing houses since December 1953 for which the rate of interest has been $4\frac{7}{8}$ per cent. In many cases since 1950, part of the sums advanced has been regarded as a suspensory loan, repayable if the house is disposed of within seven years, but otherwise bearing no interest and being converted into a grant when the seven years have expired. Over £2 million had been advanced on this basis up to 31 March 1955.

245. In the case of purchasing existing houses, loans have normally been limited to two-thirds of the value of the security, up to a maximum of £2,250; for the erection of new houses up to 90 per cent of the value of the security, with a maximum of £2,000, may be advanced. With the sharp rise in building costs and property values in the past five years it is probable that more people than previously have been forced to seek supplementary finance from other sources.

246. A further measure taken by the Government in 1953 in an effort to make housing finance more readily available on first mortgage was a mortgage guarantee scheme, enabling the State Advances Corporation to give a guarantee on behalf of the Government to approved financial institutions in relation to the portion of any loan made to a client in excess of the normal margins and up to 90 per cent of valuation with a total loan limit of £2,200. Over 1,100 home builders had been so assisted up to March 1955, involving the other institutions in loans amounting to £2·4 million, of which the Corporation had guaranteed £420,000.

247. In addition to facilitating the provision of finance for erection and purchase of homes by private citizens, the State has itself undertaken the construction, mainly for letting, of over 50,000 houses since 1937. The cumulative expenditure on the Government's housing scheme since its inception has been over £110 million. This has been financed partly from taxation but mainly from borrowing, the amounts being included in the public debt examined in paragraphs 194 to 196 above.

Borrowing for the Purchase of Consumer Goods

248. Individuals may borrow in various ways to obtain consumer goods, e.g., by obtaining goods on credit from retailers, by using cash orders, by entering into hire-purchase agreements, and so on. Unfortunately, there is not sufficient information available to give any indication of changes in the extent of borrowing of this type since 1934. We understand, however, that the Department of Statistics is currently collecting statistics of this nature.

III. THE SOURCES OF CREDIT

249. Having outlined the main groups which borrow in the credit market, and examined the sources of loan money available to each of them, we now review briefly the operations of the major financial intermediaries mentioned above, and the sources of the money which they lend.

Relative Importance of the Various Financial Institutions

250. The following table gives some indication of the relative amounts of credit extended by major financial institutions and the changes which have taken place since 1934. (For more detailed information see the table in Appendix H):

Loans and Investments in New Zealand of Various Financial Institutions as at 31 March

(£ million)

—	1934	1939	1946	1950	1955	Change 1934 to 1955
1. Reserve Bank(1)	1·5(2)	22·3	34·9	104·8	91·4	+89·9
2. Trading banks(1)	67(3)	65·8	87·1	109·5	215·3	+148(3)
3. Post Office Savings Bank ..	41·9	57·6	145·6	169·2	215·1	+173·2
4. National savings	..	..	35·0	45·7	63·5	+63·5
5. Trustee savings banks ..	10·5	13·3	30·1	40·5	49·5	+39·0
6. Building societies	8(3)	10(3)	13·5	18·0	28·9	+21(3)
7. Insurance companies(4) ..	45·5	52·6	78·4	99·7	151·5	+106
8. Government Superannuation Funds(5)	4·7	5·2	5·0	7·1	16·6	+11·9
9. National Provident Fund ..	3·4	5·3	8·1	10·7	15·5	+12·1
10. Earthquake, etc., Fund ..	..	..	4·7	6·7	12·1	+12·1
11. State Advances Corporation	47·1	57·8	55·2	79·4	125·1	+78
12. Public Trust Office ..	24·0	22·7	23·4	18·3	21·2	−2·8
13. Primary industry reserve accounts	..	..	17(6)(3)	65(6)(3)	82(6)(3)	+82(3)

(1) Figures for last balance day in March except where otherwise indicated.
(2) September 1934.
(3) Approximate only.
(4) Life, fire, accident, and marine companies. Figures for previous December.
(5) Combined Public Service, Teachers, and Railways Funds in 1934, 1939, and 1946.
(6) At end of production year.

251. The main points of interest shown by this table are as follows:

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

(b) The importance of Government-owned or Government-controlled institutions in the credit market is revealed. The Reserve Bank, the Post Office Savings Bank (with national savings), the Government Superannuation Fund, the National Provident Fund, the Earthquake and War Damage Fund, the State Advances Corporation, and the Public Trust Office are all Government institutions; the Government has a voice in the disposal of the primary industry reserve accounts; it owns a trading bank, which in 1954 did 40 per cent of the advances and deposit business of the trading banks as a whole; and it also owns important life and fire insurance offices.

(c) The Reserve Bank has become an important source of credit to the Government and to statutory marketing organisations.

(d) Trading-bank credit grew relatively slowly up till 1950 and consequently declined as a proportion of the total credit granted by the various institutions. There has, however, been a notable expansion of bank advances since 1950, restoring their position to some extent.

(e) The small savings institutions, especially the Post Office Savings Bank and national savings, received a large accretion to their funds during the war. Their rate of growth has been slower than that of the trading banks and the insurance companies since the war.

(f) The relative importance of the insurance companies declined during the war and early post-war years, but they have recovered their position to some extent since 1950.

(g) The total of loans and investments made by the Public Trust Office has declined. Consequently, its relative importance in the credit market is now less than before.

(h) The wartime and post-war stabilisation schemes led to the setting aside in reserve funds for the primary industries of substantial sums of money which became available for investment, mainly in Government securities.

The Reserve Bank

252. The operations of the Reserve Bank and the trading banks have been examined in the section of this report dealing with the monetary and banking system. Here we shall merely mention matters not dealt with elsewhere.

Management of the Reserve Bank

253. The Reserve Bank was constituted in 1933 as a corporate body with a publicly subscribed capital of £500,000 and a reserve fund of £1 million provided by the State. However, the State appointed not only the Governor and Deputy Governor, but all seven directors of the Bank. The share capital was purchased by the Government in 1936.

254. Management is vested in a Board of Directors consisting of:

(a) A Governor and a Deputy Governor appointed by the Governor-General in Council for terms of seven years:

(b) The Secretary to the Treasury, ex officio:

(c) Up to seven "ordinary members" appointed by the Governor-General in Council during pleasure, but not to hold office for more than five years without reappointment.

255. The legislation provides that there shall be an Executive Committee of the Board, consisting of the Governor, the Deputy Governor, and not less than one other member acting as such by direction of the Board, or with the Governor's concurrence. This Executive Committee is given the power to deal with any matter within the competence of the Board, but every decision of the Committee has to be submitted to the Board for confirmation at its next meeting, to which full minutes of the Committee's proceedings must also be submitted. The duties of the Governor include permanent control of the administration of the assets and general business of the bank on behalf of the Board, with authority to act and to give decisions in all matters not reserved to the Board by rules of the bank or by the Act.

Functions of the Reserve Bank

256. The main functions of the Reserve Bank are to:

(a) Act as banker to the Government, its trading Departments, and certain statutory marketing organisations.

(b) Provide a basis for clearing accounts among the trading banks.

(c) Issue notes and distribute coin.

(d) Control credit in New Zealand.

(e) Maintain adequate reserves of gold and overseas exchange.

(f) Administer exchange control.

(g) Manage the public debt.

(h) Study current economic trends and provide information to the public.

(i) Advise the Government on financial matters.

Relations with the Government

257. The changes which have taken place since 1934 in the legislative provisions affecting relations between the Reserve Bank and the Government are considered in one of the subdivisions of Section Nine of our report.

Trading Banks

Structure and Operation of Trading-bank System

258. There are five trading banks at present operating in the country. The following information about their operations is based largely on data supplied to the Commission by the Associated Banks in New Zealand.

259. Particulars of dates and places of incorporation, dates of commencement of business in New Zealand, paid-up capital, and average shareholding are as follows:

—	Incorporated	Commenced Business in New Zealand	Paid-up Capital	Average Shareholding (in Terms of Paid-up Capital)
Australia and New Zealand Bank Ltd. (In England) ..	1951	1951	£(Eng.) 10,200,000	£(Eng.) 509
Successor to Bank of Australasia (Under Royal Charter)	1835	1864	..	..
The Union Bank of Australia Ltd. .. .. (In England and in New Zealand under New South Wales Ordinance 1839 and New Zealand Private Ordinance 1844)	1837	1840	..	..
Bank of New South Wales .. .. (In New South Wales and incorporated in New Zealand under Bank of New South Wales Act 1861)	1817	1861	£(A.) 13,170,000	£(A.) 810
Bank of New Zealand .. .. .. (In New Zealand)	1861	1861	£(N.Z.) 6,328,125	(1)
The Commercial Bank of Australia Ltd. .. (In Victoria)	1866	1912	£(A.) 5,170,284	£(A.) 421
The National Bank of New Zealand Ltd. .. (In England and 1873 in New Zealand)	1872	1873	£(Eng.) 2,000,000	£(Eng.) 518

(1) Shares held by New Zealand Government.

260. Only a relatively small proportion of the paid-up capital of the four private banks has been supplied by shareholders domiciled in New Zealand.

261. As regards internal policy and general administration, the individual banks are controlled as follows:

Australia and New Zealand Bank Ltd.: By Board of Directors in London with General Manager in Melbourne. New Zealand business controlled by Chief Inspector in New Zealand.

Bank of New South Wales: By Board of Directors and General Manager in Sydney, and Inspector for New Zealand in New Zealand.

Bank of New Zealand: By Board of Directors and General Manager in New Zealand.

The Commercial Bank of Australia Ltd. By Board of Directors and General Manager in Melbourne, and Manager for New Zealand in New Zealand.

The National Bank of New Zealand Ltd. By Board of Directors in London, and General Manager in New Zealand.

262. The countries in which the banks operate and numbers of branches and agencies in New Zealand are as follows:

	Countries	Branches in New Zealand	Agencies in New Zealand
Australia and New Zealand Bank Ltd.	New Zealand ..	119	41
	Australia ..		
	Fiji		
	New Guinea ..		
	Papua		
Bank of New South Wales	New Zealand ..	83	28
	Australia ..		
	Fiji		
	New Guinea ..		
	Papua		
Bank of New Zealand	New Zealand ..	172	171
	Australia ..		
	Fiji		
	Samoa		
The Commercial Bank of Australia Ltd.	New Zealand ..	52	48
	Australia ..		
The National Bank of New Zealand Ltd.	New Zealand ..	83	42
		509	340

263. In addition, all the banks maintain offices in London and have a network of agents and correspondents throughout the world. The New Zealand business of the Australia and New Zealand Bank, the Bank of New South Wales, and the Commercial Bank is only a relatively small proportion of their total business, as the following table shows:

New Zealand Business as a Percentage of Total Business in New Zealand and Australia: Average for Year Ended January 1955

——	Deposits	Advances	Deposits plus Advances
	Per Cent	Per Cent	Per Cent
Australia and New Zealand Bank Ltd.	26·5	25·2	26·0
Bank of New South Wales ..	12·0	10·0	11·2
The Commercial Bank of Australia Ltd.	13·5	13·9	13·7

264. The following tables show the changes in the numbers of the staff of the trading banks and the wages and salaries paid to them since 1930.

Staff Numbers

	Effective Staff		On War Service		Total Staff	
	M.	F.	M.	F.	M.	F.
1930	3,142	253	..	..	3,142	253
1935	3,089	206	..	..	3,089	206
1940	3,132	327	251	..	3,383	327
1945	2,061	1,403	1,185	15	3,246	1,418
1950	3,593	1,331	..	..	3,593	1,331
1955	4,535	2,602	..	..	4,535	2,602

Salaries and Wages Payments

1930	£1,044,000	1945	£1,312,000
1935	£1,049,000	1950	£2,377,000
1940	£1,273,000	1955	£4,474,000

265. In matters of common interest, the trading banks act through an association known as The Associated Banks in New Zealand, which provides a channel through which the Reserve Bank of New Zealand and other bodies may communicate with the trading banks as a whole.

266. The Associated Banks in their submission claimed that the five trading banks operating in New Zealand are completely independent of each other with no interlocking directorates, and that each bank has a long and separate history, is proud of its traditions and standards, and jealous of its individuality. It appears that competition in advertising for accounts is keen, although there is agreement between the banks on the charges which should be made to customers for keeping accounts and on deposit rates, and little, if any, competition in rates charged on advances.

Major Services Provided by the Trading Banks

267. The major services provided by the trading banks are:

(a) The acceptance of deposits from the public, withdrawable either on demand or after a fixed term.

(b) The granting of loans to customers by way of overdraft or of discount.

(c) The provision and maintenance of the current account and cheque system.

(d) The handling of receipts and disbursements in respect of overseas currency transactions.

(e) The arrangement of shipment of produce on producers' own account.

(f) The provision of trade information.

(g) Assistance in the flotation of Government and local body loans and other public share and debenture issues.

(h) The provision of remittances, letters of credit, travellers' cheques, and general information to travellers within and beyond New Zealand.

(i) The provision of facilities for the safe custody of documents and other valuables.

(j) Miscellaneous services, such as making periodic payments for customers, publishing economic and financial information, gold assaying and refining, and acting as attorney for the holding of investments.

Customers' Accounts

268. The number of current accounts (creditor and debtor) on the books of the five trading banks in New Zealand at the end of March 1955 was approximately 497,000, of which about 110,000 were overdrawn. The total value of the debit transactions on these accounts (mainly withdrawals by cheque) for the year ended 31 March 1955 amounted to about £4,577 million, while the number of debit transactions was about 61 million.

269. The following table showing deposits held by the banks indicates the marked fall which has taken place in the relative importance of interest-bearing deposits since the period before the war:

At End of March	Interest-bearing Deposits	Non-interest-bearing Deposits	Percentage of Interest-bearing to Non-interest-bearing Deposits	Rate of Interest on Twenty-four Months Fixed Deposits
	£ million	£ million	Per Cent	Per Cent
1928	26·8 (9 April)	25·7 (9 April)	104	5
1934	39·9	23·5	170	3
1938	33·1	33·6	99	2½
1945	33·1	89·4	37	2
1955	40·0	237·1	17	2

(Weekly returns to Department of Statistics. Government deposits are excluded.)

270. The reader will note the relative popularity of interest-bearing deposits in the depression year 1934, showing that many persons with purchasing power available had little desire to exercise it quickly. The position was very different in 1955.

271. At the end of March 1955, £33·6 million of the interest-bearing deposits had been left with the banks for fixed terms as follows:

	£ million
Fixed—	
For three months	1·5
For six months	4·0
For twelve months	9·6
For twenty-four months	18·5
	£33·6

272. The latest information available to the banks at the time of our hearings showed that 77 per cent of customers with credit current accounts had balances of under £500, and the average credit balance of all current account customers was £625.

273. Regardless of the extent of operations on his account, each customer is charged 10s. per half-year. In addition, charges are made for collecting cheques or drafts on other centres, amounting to 6d. for sums up to £20, and increasing after that by 3d. for every additional £10, with a limit of £2 10s.

274. The following table gives an indication of the relative importance of the trading banks as holders of deposits:

Deposits to Credit of Customers at Certain Financial Institutions

(£ million)

	As at 31 March			
	1934	1939	1946	1955
Trading banks(1)	63·4	67·0	143·6	297·8
Post Office Savings Bank	44·9	60·7	128·5	215·7
National savings			26·9	68·2
Trustee savings banks	10·8	13·9	27·3	42·8
Building societies	2·3	3·7	4·6	4·4
Trading companies	6·0	5·1	5·5	N.A.

(1) Includes demand, fixed, and wool retention deposits.

275. The trading banks estimated on the basis of investigation of overdraft accounts of one bank that 58 per cent of the customers with overdraft accounts had limits of under £500 at September 1954. The following are the figures supplied:

Bank Overdraft Limits as at 30 September 1954

Extent of Limit	Number of Accounts
Small, casual, and temporary advances (no formal limit) ..	13,750
Up to £500	44,550
£501 to £1,000	21,175
£1,001 ,, £5,000	25,300
£5,001 ,, £10,000	2,750
£10,001 ,, £20,000	1,200
£20,001 ,, £30,000	364
£30,001 ,, £50,000	283
£50,001 ,, £100,000	227
£100,001 ,, £250,000	183
£250,001 ,, £500,000	59
£500,001 ,, £750,000	19
£750,001 ,, £1,000,000	12
Over £1,000,000	6

276. Interest is charged on the actual daily balance of overdrawn accounts.

277. Up till December 1955, rates of interest charged to customers on overdrafts varied within a range of from 4 to 5 per cent. As a general rule, the minimum overdraft rate is confined to concerns handling the country's primary export production (such as dairy companies, meat operating companies, and wool buyers) and to churches, charitable organisations, and local bodies. The average overall rate, i.e., for all overdrafts at all banks for the year to 31 March 1955, was approximately £4 11s. 8d. per cent per annum, as against an average rate of interest permitted by agreement with the Government of £4 15s. per cent per annum. (Note – The permitted average was raised early in 1956 to £5 per cent per annum.)

The Bank of New Zealand

278. The Bank of New Zealand was nationalised in 1945. Even before that time the Government was in a position to exert an influence on the operations of the bank in that since 1898 it had appointed four of the six directors. In 1945, all the private shares were bought by the State and the Minister of Finance was given power to make all the appointments to the Board of Directors. The members are required by the Act to *"have regard to any representations that may be made to them by the Minister of Finance and shall give effect to any decision conveyed to the Board in writing by the Minister"*.

Relative Shares of Business

279. The following table gives some idea of the proportions of the commercial banking business of New Zealand carried out by each of the banks (the statistics are averages of the monthly figures for 1954):

—	Demand Liabilities		Advances and Discounts	
	£ million	Percentage of Total	£ million	Percentage of Total
Australia and New Zealand Bank Ltd.	50·9	21·8	35·5	22·9
Bank of New South Wales ..	31·1	13·3	18·4	11·9
Bank of New Zealand ..	93·3	39·9	61·9	40·0
Commercial Bank of Australia Ltd.	15·8	6·8	10·5	6·8
National Bank of New Zealand Ltd.	42·5	18·2	28·6	18·5
Total	233·6	100·0	154·8	100·0

Savings Banks

280. A substantial proportion of the savings of the people is channelled to the Government, to local bodies, and to private borrowers through savings banks.

281. The main "small savings" institution in the country is the Post Office Savings Bank, which held deposits to the credit of about 1,537,000 customers in New Zealand at the end of March 1955. According to the 1955 *Year-Book*, there were 970 branches of the Post Office Savings Bank throughout the country, 172 being ledger offices providing demand withdrawal facilities. About 95 per cent of withdrawals were made in this manner, the remainder being made by free telegram or money order, mainly by country depositors who could not attend personally at a ledger office.

282. There are five trustee savings banks, situated respectively in Auckland, New Plymouth, Dunedin, Invercargill, and Hokitika. These held deposits to the credit of over 382,000 customers at 31 March 1955. Withdrawals are normally made by personal application, but the Invercargill Savings Bank permits withdrawal by cheque.

283. The Post Office also conducts a school savings bank scheme. There were 145,000 school accounts open on 31 December 1954.

284. The National Savings Act 1940 made provision for the issue of savings bonds, in denominations of £1, £10, and £100, and the opening of special savings accounts with the Post Office and the Auckland, New Plymouth, Dunedin, and Invercargill Trustee Savings Banks. Investments in bonds are for a period of five years, and in the savings accounts for two years, though releases can be obtained in cases of hardship or emergency.

285. The following table shows amounts to the credit of customers in the Post Office and trustee savings banks, national savings, and school savings accounts in selected years since 1934:

Amounts to Credit of Customers in Savings Accounts

(£ million)

As at 31 March	Post Office Savings Bank	Trustee Savings Banks	National Savings	School Savings
1934	44·9	10·8	..	..
1938	63·1	13·3	..	0·05
1946	128·5	27·3	26·9	0·2(1)
1950	171·0	34·9	47·7	0·3(1)
1955	215·7	42·8	68·2	0·7(1)

(1) Previous December.

286. The following is a classification of the balances in Post Office Savings Bank accounts at 31 March 1955, showing the number of accounts within the stated limits and the percentage of total accounts within each group:

—	At 31 March 1955	Percentage of Total
Under £1	354,535	23·06
£1 and under £10	368,070	23·94
£10 " £50	289,714	18·85
£50 " £100	123,786	8·05
£100 " £200	125,955	8·19
£200 " £300	70,734	4·60
£300 " £400	45,777	2·98
£400 " £500	36,952	2·40
£500 " £600	27,347	1·78
£600 " £700	16,486	1·07
£700 " £800	12,367	0·81
£800 " £900	10,059	0·66
£900 " £1,000	8,299	0·54
£1,000 " £1,500	23,897	1·56
£1,500 " £2,000	11,022	0·72
£2,000 " £3,000	9,217	0·60
£3,000 " £4,000	1,828	0·12
£4,000 " £5,000	674	0·04
£5,000 and over	487	0·03
Total number of accounts	1,537,206(1)	100·00

(1) Excludes 17,343 accounts domiciled at Apia and Raratonga.

287. The value of national savings bonds sold and redeemed each year since 1940–41 is given in Table 41 in Appendix H. About £9·6 million was raised in this way between 1940 and 1946, but since then redemptions have heavily outweighed the value of bonds sold.

288. The following figures indicate the value of new deposits in and withdrawals from the main savings institutions in the March year 1954–55 (figures for other years are to be found in Tables 38 to 40 in Appendix H):

Value of Deposits and Withdrawals, 1954–55

——	Deposits	Withdrawals	Ratio of Withdrawals to Amounts to Credit of Customers as at March 1954
	£ million	£ million	Per Cent
Post Office Savings Bank ..	117·9	112·8	55
Trustee savings bank ..	26·9	26·2	64
National savings	11·1	10·3	16

289. The last column of the above table shows the relationship of the withdrawals made during the year in each type of institution to the amounts standing to the credit of customers at the beginning of the year. It is interesting to compare these figures with figures showing the relationship between amounts available to trading-bank customers at March 1954 and the value of debit transactions during the following year. Since cheques may be drawn against unexercised overdraft limits we include these among the amounts standing to the credit of customers in the following table:

Total Deposits, End March 1954 (a)	Total Deposits + Unexercised Overdraft Authorities, End March 1954 (b)	Value of Debit Transactions April 1954 to March 1955 (c)	Ratio of (a) to (c)	Ratio of (b) to (c)
£ million	£ million	£ million	Per Cent	Per Cent
282·3	385·8	4,577	1,621	1,186

290. Comparison with the figures for the savings banks gives a striking illustration of the relative rates of turnover of the sums standing to customers' credit at the different institutions. Sums lodged in the savings banks, although repayable on demand, tend to remain there for a relatively long period; sums lodged in trading banks are, in the main, intended for use in the very near future.

Restrictions on Trustee Savings Banks

291. Certain restrictions are imposed on the expansion of trustee savings banks by section 5 of the Trustee Savings Bank Act of 1948. The cities and boroughs where trustee savings banks may operate are stipulated to be the five places now served by such banks, and it is laid down that no bank shall establish any new branch office or agency more than twenty-five miles from its head office.

292. The 1948 Act required the trustee savings banks to hold not less than 40 per cent of their investments in the form of Government stock up till 1 April 1954, when the requirement was raised to 50 per cent. They are also required to keep a sum not less than 5 per cent of their depositors' balances in cash in hand or on current account at a trading bank.

293. In section 30 of this Act, the State guarantees the repayment of deposits held by the trustee savings banks.

294. The maximum rates of interest which may be allowed on deposits are fixed by Order in Council for both the trustee savings banks and the Post Office Savings Bank. The rates fixed in recent years are set out in Table 53 in Appendix H.

Investments by Trustee Savings Banks

295. The following figures show the general pattern of the investments of the trustee savings banks at selected dates since 1934. The more detailed figures for 1953 to 1955 in a table in Appendix H show that there are marked differences in the pattern as between the five banks:

Investments of Trustee Savings Banks

(£ million)

—	1934	1939	1946	1950	1955
Mortgages	5·9	7·0	6·8	8·1	13·6
New Zealand Government securities	2·7	3·8	20·7	29·9	30·6
Local authority securities	1·9	2·5	2·6	2·5	5·3
	10·5	13·3	30·1	40·5	49·5

296. The lending on mortgage is primarily for residential purposes, except in Invercargill and New Plymouth, where rural mortgages predominate. The banks do not lend on table mortgage. Most of their mortgages are repayable on demand and, in Auckland, customers may make repayments in multiples of £5 on any quarter day without notice.

297. The majority of the new funds of the trustee savings banks were, by force of circumstance, channelled into Government securities during the war and early post-war period, so that by 1950 nearly three-quarters of their total investments were in this form, as compared with less than 30 per cent before the war. Since 1950, a greater proportion of their investments has been made in mortgages and local body securities, but they still have about 60 per cent of their total investments in Government stock.

298. The sums collected by the Post Office Savings Bank and in national savings and school savings accounts are invested almost entirely in Government or State Advances Corporation stock.

Building Societies

299. Building societies are important sources of finance for those wishing to build or buy houses.

300. The following extract from the *Official Year-Book* for 1955 distinguishes the different types of building society, the respective sources of their funds, and the types of loan made:

A distinction is made between permanent and terminating societies. A permanent society is statutorily defined as one which has not by its rules any fixed date or specified result at which it shall terminate, and a terminating society as one which by its rules is to terminate at a fixed date, or when a result specified in its rules is attained. In practice a terminating society, or a group thereof, closes when every member so desiring has obtained a loan. There is a considerable difference between the two types of societies, the terminating society being a purely co-operative institution belonging to and managed by the members, proprietary interests being discouraged by placing a limit to the number of shares (usually ten) that any member may hold in any one group. There is, however, nothing to prevent a member from holding the maximum number of shares in more than one group. In a typical terminating society contributions are at the rate of 1s. per week per share, each share entitling a member in due course to £200 of loan, with a maximum, until recent years, of £1,200. As £1,200 is not sufficient to meet the needs of the average prospective house owners on present-day costs, there is a tendancy for the limit to be raised. In some groups of the terminating societies the loan maximum is now £3,000. It is these contributions, together with premiums on loans mentioned later, which make up the funds from which loans are made. Loans are made to members both by ballot and by auction, the latter going for the highest premium offered. Security is required for the loans, which are repaid, free of interest, in periods varying from ten to twenty years. The weekly payment of 1s. per share is continued, usually till the end of the group, but sometimes only until the total contributions paid in, plus profits, credited to the shareholder, equal the amount owing on the loan. The shareholder's credit balance is then transferred to extinguish the loan. The profit of the society is derived from premiums on loans sold by auction.

Permanent societies are more in the nature of finance companies, and, while both investors and borrowers must be members, the borrower is frequently merely a nominal member. Investments in a permanent society may be made in either large or small amounts. Capital may be raised by shares with a fixed rate of interest, or subject to dividends varying according to profits. As will be observed from the statistics which follow, terminating societies do not issue capital shares. Bonds, debentures, deposits, and overdraft are other methods of financing. The principal object of a permanent society is to lend money at a profit on land and buildings, either freehold or leasehold. Table mortgages are normally adopted, the usual term of repayment being up to twenty years.

301. The number of borrowers and amounts of loans outstanding at the end of each of the March years 1934, 1939, 1946, 1950, and 1955 were as follows:

Loans of Building Societies Outstanding

Year	Permanent Societies		Terminating Societies		Total	
	Number	Amount	Number	Amount	Number	Amount
		£ million		£ million		£ million
1933–34 ..	9,674	5·20	7,983	2·63	17,657	7·84
1938–39 ..	13,229	7·27	8,024	2·58	21,253	9·86
1945–46 ..	14,780	8·89	8,758	3·59	23,538	12·48
1949–50 ..	15,344	11·04	10,382	5·30	25,726	16·35
1954–55 ..	15,396	14·97	16,777	11·66	32,173	26·63

There has been a notable expansion of lending, especially by terminating societies, since 1950.

302. The extent to which building societies can lend in any year depends primarily on the share contributions which they receive from members, on the excess of deposits with them over withdrawals, and on the extent of repayment of past advances. An indication of the relative importance of these sources of finance is given by the following summary of receipts and payments for all societies for 1954–55:

Receipts and Payments of Building Societies, 1954–55

Receipts	£	*Payments*	£
Share subscriptions	3,326,044	Members' withdrawals ..	748,610
Advances repaid	3,513,092	Advances	6,417,680
Deposits	2,736,251	Management expenses ..	269,815
Interest	686,539	Dividends paid	111,178
Other receipts	698,036	Deposits withdrawn	2,506,005
		Interest paid	230,563
		Other payments	785,293
	£10,959,962		£11,069,144

303. The following table shows the liabilities and assets of all building societies combined on the dates concerned:

Liabilities and Assets of Building Societies for Years Ending March

—	1934	1939	1946	1950	1955
	£	£	£	£	£
LIABILITIES					
To shareholders (including reserve funds and undivided profit) ..	5,923,351	6,495,079	8,529,033	13,238,029	23,736,446
Deposits	2,285,874	3,667,846	4,589,615	4,035,617	4,357,998
Appropriations not taken up or in trust	184,621	243,787	463,988	857,184	1,495,648
To bankers and other creditors ..	190,304	348,146	357,954	877,671	1,449,589
Total liabilities	8,584,150	10,754,858	13,940,590	19,008,501	31,039,681
ASSETS					
Advances on mortgage([1]) ..	7,881,372	9,855,075	12,479,437	17,244,136	28,499,228
Other investments and assets ..	429,619	610,048	968,896	1,462,543	2,325,862
Cash in hand and at bank ..	273,159	289,735	492,257	301,822	214,591
Total assets	8,584,150	10,754,858	13,940,590	19,008,501	31,039,681

([1]) Includes balance owing on premiums on loans.

Institutions for Insurance and Superannuation

304. The fact that persons are anxious to insure themselves or their families against the risks of life and death and to make provision for an adequate income in their old age brings large sums of money each year into the hands of the institutions which have been set up to cater for their demands. The institutions, in turn, are anxious to invest the funds which they acquire in profitable but reasonably safe securities, to enable them to provide the maximum degree of protection for their customers at the lowest possible cost.

305. The following figures summarise and show the distribution of the loans which the major institutions in this field had made as at selected dates since 1934:

Loans by Insurance and Superannuation Institutions as at 31 March

(£ million)

—	1934	1939	1946	1950	1955
Insurance companies(1)(2)—					
Mortgages	8·2	11·6	12·5	18·7	58·1
Loans on policies	6·0	5·5	3·8	3·6	4·2
Local authority securities ..	16·3	19·9	23·3	25·7	32·6
New Zealand Government securities	15·0	15·6	38·8	51·7	56·6
	45·5	52·6	78·4	99·7	151·5
Earthquake and War Damage Fund—					
New Zealand Government securities	..	..	4·7	6·7	12·1
Government Superannuation Funds(3)					
Mortgages	3·2	2·6	1·9	0·8	0·4
Local authority securities ..	0·8	1·1	0·9	0·6	0·4
New Zealand Government securities	0·7	1·5	2·2	5·7	15·8
	4·7	5·2	5·0	7·1	16·6
National Provident Fund(1)—					
Mortgages	1·3	1·1	0·8	0·7	1·0
Local authority securities ..	0·2	0·5	0·4	1·1	9·1
New Zealand Government securities	1·9	3·7	6·9	8·9	5·4
	3·4	5·3	8·1	10·7	15·5
Totals—					
Mortgages	12·7	15·3	15·2	20·2	59·5
Loans on policies	6·0	5·5	3·8	3·6	4·2
Local authority securities ..	17·3	21·5	24·6	27·4	42·1
New Zealand Government securities	17·6	20·8	52·6	73·0	89·9
	53·6	63·1	96·2	124·2	195·7

(1) As at end of previous December.
(2) Life, fire, accident, and marine companies.
(3) Combination of Public Service, Teachers, and Railways Funds in 1934, 1939, and 1946.

306. The most interesting feature of this table is the growth in the relative importance of loans to the Government by this group of institutions, especially up to 1950. Whereas before the war the total of their loans was divided more or less equally among the Government, the local authorities, and private borrowers, 59 per cent of the total in 1950 was in Government securities. Since 1950, as a result of insurance companies directing their funds primarily into mortgages, the private sector has increased its share of the loans made by these institutions while the local authorities' share has remained stable, despite the concentration of the National Provident Fund on local body securities. As at early 1955, about 46 per cent of their loans were in Government securities, 33 per cent in mortgages or loans on policies, and 21 per cent in local authority securities.

307. By far the most important sources of credit among this group of institutions are the life-insurance companies. In 1954, there were fifteen life insurance offices conducting business in New Zealand, including the Government Life Insurance Office. These offices are

organised either entirely on the mutual principle or, in the case of companies having a share capital, the interests of the shareholders are limited. Only four of the offices are purely New Zealand institutions.

308. The growth of life insurance in New Zealand is shown in the following table:

Policies Existing at End of Year

Year	Number	Sum Assured	Annual Premium Income
		£	£
1939	837,453	170,415,223	5,877,652
1946	1,095,583	265,852,607	9,063,972
1950	1,261,054	387,216,172	12,801,138
1953	1,383,709	529,107,427	17,094,440
1954	1,429,756	591,790,390	18,947,766

309. The following table shows the payments made to policy holders arising under claims at death and on maturity of policies in the years stated:

Year—	£	Year—	£
1939	2,943,932	1953	7,105,249
1950	5,474,098	1954	7,398,986

310. The distribution of assets held by the life offices in respect of New Zealand business at the end of 1953 was as follows:

Assets	Amount	Percentage of Total
	£	
Mortgages on property	47,311,935	33·863
Loans on policies	4,103,459	2·937
New Zealand Government securities	42,101,216	30·133
Securities of other Governments	1,797,369	1·286
Local authority securities	30,929,187	22·137
Landed and house property	3,426,941	2·453
Other investments	5,469,705	3·915
Outstanding premiums	943,440	0·675
Interest accrued, etc.	1,149,414	0·823
Cash	1,082,475	0·775
Other assets	1,402,097	1·003
	139,717,238	100·000

311. The detailed Table 47 in Appendix H shows changes in the distribution of the assets of life insurance companies since 1928. Loans to the private sector in the form of mortgages and loans on policies were a high proportion of total assets (43 per cent) in 1928, but fell proportionately during the thirties to about one-third of total assets. Total lending to the private sector remained fairly stable during the war, while lending to the public sector increased considerably, and by 1946 loans on mortgage and on policies were only about 20 per cent of total assets. Since then, and particularly since 1950, funds lent to the private sector have ex-

panded considerably, and represented nearly 40 per cent of total assets in December 1954. Changes in the type of mortgage taken up by the largest company since 1939, together with a break-up of mortgages on city and suburban properties as at December 1954, are given in the following table:

Mortgages on Property – New Zealand Business Analysis According to Type of Security: Australian Mutual Provident Society

Date: 31 December	Farm Properties		City and Suburban Properties		Total	
	Number	Amount	Number	Amount	Number	Amount
		£		£		£
1939	404	3,208,801	270	983,276	674	4,192,077
1946	528	3,304,354	422	1,351,448	950	4,655,802
1950	780	3,788,049	2,134	5,908,133	2,914	9,696,182
1952	1,162	6,081,876	3,431	12,641,544	4,593	18,723,420
1953	1,339	7,171,496	3,636	14,635,138	4,975	21,806,634
1954	1,537	8,650,986	4,405	17,005,604	5,942	25,656,590

—	Farm		Home Purchase		Commercial and Industrial		Total	
	Number	Ledger Balance	Number	Ledger Balance	Number	Ledger Balance	Number	Ledger Balance
		£		£		£		£
1954 ..	1,537	8,650,986	3,911	7,041,574	494	9,964,030	5,942	25,656,590

312. The growth of the relative importance of urban mortgages, especially since 1950, and the predominance of commercial and industrial mortgages as at 31 December 1954 are noteworthy features.

313. Lending to local authorities expanded markedly in the 1930's, and as a result local authority securities rose from 14·5 per cent of life insurance companies' assets in 1928 to over 39 per cent throughout the thirties.

314. However, during the war, the bulk of the companies' funds for investment were directed to Government securities, and since the war, and particularly since 1950, they have found mortgages a more attractive investment than local authority securities. Consequently, by December 1954, local authority securities comprised only about 20 per cent of their total assets.

State Advances Corporation

315. The following information on the operations of the State Advances Corporation has been compiled largely from a statement made to the Commission by the Managing Director of the Corporation.

316. The New Zealand Government set up an Advances to Settlers Department as early as 1894 to provide loans on mortgage to settlers for land-development purposes at economic interest rates and on stable terms and conditions. The Department later became the State Advances Department and extended its functions, particularly into the provision of finance for housing.

317. The report of the Superintendent in 1933 stated that from the inception of the Office in 1894 until that year nearly £75½ million had been advanced of which £31½ million had been repaid. At that time, however, loans were very restricted and many mortgagors were in difficulties which, of course, was the experience also of other financial institutions.

318. Following a survey of economic conditions and the existing mortgage situation at that time, the Government came to the conclusion that in addition to the mortgagors' relief legislation, the need was also established "for organising mortgage finance on a more comprehensive basis – thereby strengthening this part of the financial structure of the Dominion". The result was the establishment in 1935 of the Mortgage Corporation of New Zealand. The original capital was fixed at £1 million in £1 shares of which 500,000 were in terms of the Act allotted to the Crown and the remainder offered for public subscription. Provision was also made for the issue of bonds, stock, or other securities.

319. However, in July 1936 – following a change of Government – the constitution of the Mortgage Corporation was altered. The name of the institution was changed to the State Advances Corporation, and the private share capital of £500,000 was purchased by the Government. The Board was reconstituted to comprise two joint Managing Directors (to function as Chairman and Deputy Chairman), the Secretary to the Treasury, and two other directors appointed by the Government. In 1951 the constitution of the Board was again altered to comprise the Managing Director and a Deputy Managing Director (who function respectively as Chairman and Deputy Chairman of the Board), the Secretary to the Treasury, and other directors (at present three) appointed by the Government.

320. The principal business of the Corporation was restated as *"the making of loans in accordance with the provisions of the principal Acts – as amended – with a view to giving effect to the policy of the Government in that respect as communicated to it from time to time by the Minister of Finance"*.

321. Important extensions were made also on the following lines:

(a) Securities issued by the Corporation were to be State guaranteed.

(b) Restrictions on the borrowing powers of the Corporation were removed.

(c) The Minister of Finance was given power to require the Corporation to redeem Corporation stock held by the Crown from time to time.

(d) Loans approved by the Corporation in excess of two-thirds of the value of the security were to be State guaranteed.

(e) Consent of the Corporation was made necessary to validate any second or subsequent mortgages.

(f) Provision was made for loans for the development of any industry within New Zealand or for the establishment of any new industry. Loans were to be approved as to terms and conditions by the Minister of Finance and guaranteed by the State.

(g) The Corporation was empowered to undertake inspections of properties and other works for Departments of State.

322. Over the period of the twenty years ended March 1955, loans authorised on mortgage were:

89,100 urban for	£116 million
19,500 rural for	£72 million
108,600	£188 million

323. The loan authorisations for the financial year 1954–55 (included in the above figures) in these two main classes were:

Rural: 1,400 for approximately £6 million.
Urban: 8,700 for approximately £15 million.

324. Depending to a certain extent on seasonal effects on rural accounts, the repayments of principal over the last five years varied between £8 million and £10 million. These sums were, of course, available for relending.

325. The Corporation's policy has been to use sparingly the provisions permitting loans to industry. The loans made have been in the main for development and expansion of business activities, which were important from a national viewpoint, but for which the promoters were unable to obtain finance through normal channels.
Examples are:

(a) Loans to manufacturers co-opted during the war to provide munitions, specialised equipment, and goods required by the Army and other phases of wartime operations.

(b) Loans to the farming industry to expand production, i.e., cost of conversion of butter factories to cheese to fit in with the requirements of the United Kingdom.

(c) Finance for organisation and establishment of milk-pasteurisation factories in the main centres and certain aspects of the fruit industry.

326. However, the total amount advanced was only a little over £2 million. The need for much further activity in this section is said by the Corporation to be not apparent at present.

327. The Corporation acted as agent for and on behalf of the Rehabilitation Board, and the figures to the end of 31 March last revealed the following broad classification and number of rehabilitation loans authorised:

—	Number	Amount
		£
Tools of trade	1,470	48,600
Furniture	61,170	5,731,000
Business	11,170	7,241,000
Miscellaneous.. ..	660	131,300
Housing	49,180	67,284,000
Farms	10,600	57,400,000

328. These loans carry special concession rates of interest, the difference between these and the Corporation rates being recovered from Treasury. The Treasury provides the funds interest free from which suspensory loans are granted. These suspensory loans are made for new houses, or, after the repeal of the Land Sales Act, for farms acquired by ex-servicemen. (The figures shown for housing and farm loans are included in the total loan authorisations shown previously.)

329. The following table shows the distribution of the Corporation's assets as at various dates since 1934:

	As at 31 March £ million				
	1934	1939	1946	1950	1955
Mortgages—					
Rural	42·5	25·5	23·6	36·6	50·5
Urban		26·1	23·8	38·4	65·6
Industrial loans					1·5
Government and local authority securities	4·6	6·2	7·8	4·4	7·5
	47·1	57·8	55·2	79·4	125·1

330. The Corporation since 1936 has administered the housing units erected under the State rental housing scheme and the associated Housing Account.

331. The Government introduced a plan in 1950 to enable tenants to purchase the houses they occupied. According to the Corporation, this has proved very popular and since the new policy was brought into operation approximately 11,000 units have been sold. The terms of sale were attractive and the effect on the finances of housing administration has also been favourable.

332. Due to a failure to raise rentals sufficiently in the face of rising construction costs, the accumulated loss in the revenue account of the housing administration to 31 March 1955 was calculated by the Corporation to have been approximately £1,166,100, and the current annual deficiency in respect of the State rental units is estimated at approximately £300,000.

333. The majority of the stock issued by the Corporation to obtain funds for lending is held by the Post Office Savings Bank. As mentioned previously, £12 million of its stock was placed with the trading banks in 1954.

The Public Trust Office

334. The Public Trust Office is an important factor in the credit system because it acquires a considerable volume of funds which it invests in the course of its varied operations, e.g., as administrator of intestate estates; executor and trustee under wills; trustee under marriage and other settlements; trustee of benefit or relief funds; agent or attorney for absentees or persons desiring to be relieved of business worries; sinking fund commissioner for local authorities; administrator of unclaimed lands and property; statutory administrator of the estates of mental patients

(other than Maoris) where no committee of the estate has been appointed by the Court; manager (when so appointed by the Court) of the estates of aged and infirm persons unable to administer their own affairs; administrator of compensation moneys payable in respect of the death of a worker (unless the Court orders otherwise); and agent for the investment of certain moneys of the National Provident Fund and the administration of mortgage investments forming part of the Government Superannuation Fund.

335. The following is a classification of the estates and funds which came under administration during the year ended 31 March 1954 and of all estates and funds under administration at that date:

	New Estates and Funds During 1953–54		Estates and Funds Under Administration at 31 March 1954	
	Number	Value	Number	Value
		£		£
Wills estates	2,141	6,467,116	7,708	28,060,188
Trusts and agencies	279	800,616	2,396	10,024,997
Intestate estates	575	591,225	1,625	1,299,844
Mental patients' estates	862	1,824,501	3,908	6,097,239
Miscellaneous estates and funds ..	163	1,277,743	2,377	16,260,271
Totals	4,020	10,961,201	18,014	61,742,539

336. The following table shows the distribution of the investments made by the Public Trustee as at selected dates since 1934:

(£ million)

—	1934	1939	1946	1950	1955
Public Trust Office—					
Mortgages	13·2	11·8	9·8	9·1	13·4
Local Authority debentures ..	7·9	6·8	5·8	4·8	3·2
Government securities	2·9	4·1	7·8	4·4	4·6
	24·0	22·7	23·4	18·3	21·2

337. It will be noted that total lending by the Public Trust Office was lower in 1955 than in 1934. As a result, the office is relatively a less important factor in the credit system than it used to be. There are several reasons for this. The main one is that securities to a value of over £8 million held on behalf of the Public Debt Redemption Fund were withdrawn in 1948. Another reason is the effect of mortgagors' relief and local bodies' conversion legislation in the 1930s.

Farm Industry Reserves

338. A new and important source of credit, particularly for the Government, was developed as a result of the war and post-war policy of stabilising the incomes of meat and dairy producers, and as a result of the

capital profits and other surpluses which accrued to New Zealand through its participation in the Joint Organisation Scheme for the disposal of surplus wartime stocks of wool.

339. The following table shows the growth of the industry reserves since 1942:

Farm Industry Reserves

Balances as at 31 July	Dairy Industry Stabilisation Account	Meat Industry Reserve Accounts	Wool Capital Account[2]	Wool Contributory Charge[3]
	£(N.Z.)	£(N.Z.)	£(Stg.)	£(N.Z.)
1942	..	749,801	..	..
1944	1,066,599	4,317,432	..	..
1947	8,907,459	18,222,140	5,046,287 Dr.	1,165,402
1951	23,037,189	37,255,651 [1]	19,608,187 Cr.	6,166,721
			Wool Commission Capital Account[4]	
			£(N.Z.)	
1952	23,584,778	40,429,379 [1]	26,672,685 [5]	
1953	24,147,261	40,449,822 [1]	27,630,163 [5]	
1954	24,739,485	39,550,761 [1]	28,387,868 [5]	
1955	23,496,481	40,980,000 [1]	29,077,525 [5]	

(1) As at 30 September.
(2) Profits from disposal of wool stocks taken over by Wool Disposal Commission at the end of the war.
(3) This is a levy on all wool sold at auction.
(4) The balances of both the Wool Capital Account and the Wool Contributory Charge Account were transferred to the Wool Commission Capital Account as from 1 January 1952.
(5) 30 June.

340. Most of these funds have been invested in New Zealand Government securities. The Wool Commission holds a small proportion of its reserves in British Government securities. Reserves held in this form have grown slowly over the years to about £1 million in June 1955. The Wool Commission also holds New Zealand Government stock in London to the extent of £2¼ million.

341. The Dairy Products Marketing Commission since 1952–53 has made several loans to dairy factories, but in July 1955 these amounted to only about £714,000 as compared with £14·3 million invested in Government securities. Most of the remainder of the funds in the Stabilisation Account are required as working capital by the Commission.

342. As at 30 September 1955, all the funds in the Meat Industry Reserve Account were invested in Government stock, except for a debenture of £960,000 in a fertiliser company. Some of the funds in the Meat Board's own Reserve Account have been used to make loans on mortgage to aerial topdressing companies, totalling £245,000 in September 1955.

Trading Companies, Finance Companies, Investment Companies, Trustee Companies

343. There is not sufficient information available to enable us to examine the magnitude and direction of the lending and borrowing activities of trading, finance, investment, and trustee companies in New Zealand. It seems most desirable that steps be taken by the appropriate authorities to acquire and publish the statistics necessary to improve knowledge in this field. The activities of these companies in the credit system

are by no means negligible, e.g., the Secretary of the New Zealand Stock and Station Agents' Association estimated that total advances (short and long term) to farmers by stock and station agents was not less than £20 million.

344. Again, trading companies hold substantial sums on deposit. Some indication of the amounts involved can be gauged from the figures supplied to the Treasury up till 1947.

Deposits with Trading Companies as at 31 March
(£(N.Z.))

—	At Call	3 Months and under 2 Years	Two Years or Over	Totals
1934	3,292,740	1,004,031	1,691,344	5,988,115
1935	2,756,187	1,106,836	1,983,391	5,846,414
1936	2,583,167	1,077,754	1,887,648	5,548,569
1937	2,297,438	1,100,109	1,840,630	5,238,177
1938	2,154,307	1,045,739	1,897,136	5,097,182
1939	2,151,353	1,005,715	1,927,142	5,084,210
1940	2,111,470	1,148,445	1,867,442	5,127,357
1941	2,163,558	1,439,932	1,909,233	5,512,723
1942	2,072,634	1,101,813	2,520,567	5,695,014
1943	2,159,064	1,060,844	2,337,672	5,557,580
1944	1,635,665	1,209,096	2,260,818	5,105,579
1945	1,706,039	910,238	2,180,514	4,796,791
1946	2,342,723	1,037,871	2,095,624	5,476,218
1947	2,070,046	784,324	2,136,703	4,991,073

345. The eleven stock and station agency firms surveyed by the Reserve Bank in its analysis of the financial statements of 203 public companies held deposits equal to £5,567,000 in 1953 and £5,797,000 in 1954.

The Stock Exchange

346. The following extracts from the submissions of the Stock Exchange Association outline the role of the Stock Exchange in the New Zealand credit system:

The Stock Exchange is a market place where those who own funds exchange them for stocks and shares and vice versa.

The presence of an open market where the owner of securities may sell them, if at any time he wishes to do so, is a powerful factor in inducing original investment. The Stock Exchange provides for the owner of funds or securities the facilities whereby he may exercise the right to change his mind . . .

Cash is the basis of all transactions and . . . members do not act as bankers for their clients. Operating on "margin" is virtually unknown in New Zealand.

In New Zealand sharebrokers are licensed under the Sharebrokers' Act 1908. There are five recognised Stock Exchanges – Auckland, Wellington, Christchurch, Dunedin, and Invercargill. These five Exchanges are affiliated with the Stock Exchange Association of New Zealand and nominate delegates to attend annual conferences of their body.

Each Exchange manages its own domestic affairs, while the Association formulates rules to maintain uniformity of practice (for example in regard to brokerage and settlement dates) throughout the Dominion. Under the Act those rules of the Association, and also the rules of each Stock Exchange, must be approved by the Governor General in Council and gazetted.

The members of an Exchange have agents throughout the Dominion and overseas who are likewise members of "recognised" Stock Exchanges.

Besides acting in the buying and selling of existing shares, members of the Stock Exchange act as Organising Brokers to new issues and also as underwriters of new issues . . .

Under the rules of the Stock Exchange Association, members may not act in a flotation unless authorised to do so by the Committee of an affiliated Exchange. Such authorisation is given only if the Committee is satisfied that the Prospectus sets out clearly the prospects for the success of the undertaking.

The Stock Exchange also plays its part in assisting the Government in obtaining capital funds. It is believed between 20 per cent and 25 per cent of all subscriptions to Government loans is found by the Stock Exchange Association and that approximately 33⅓ per cent of Local Body securities are placed by the Stock Exchange.

The mainstay of the average sharebroker's business is a substantial number of small orders. This is borne out by a perusal of reported sales in the daily newspaper.

For the purpose of this submission we sought figures to substantiate this statement. One Wellington office advised us that its last fifty (50) buying orders averaged £245.10.0., the largest being £1,047 and the smallest £19.15.11. Another Wellington office has supplied similar figures showing an average of £283.5.8., the largest transaction being £1,006 and the smallest £13.19.9. An interesting feature of these figures was that in the case of the first office 23 of the buying orders were received from women, and in the case of the second office, 14 orders were received from women.

Another Stock Exchange reports that of the last fifty buying orders received from clients (excluding Government Stock) by each of six members of the Exchange, i.e. a total of 300 buying orders, 178 were for £300 or under. The 178 clients were of 52 different occupations as follows:—

Married women	34	Retired	3
Farmers	17	Spinsters	10
Printers	1	School teachers	1
Retired farmers	8	Agricultural inspector	1
Company secretaries	4	Drapers	2
Students	2	Flour millers	1
Clerks	5	Housing inspectors	1
Public accountants	4	Retired army officers	1
Accountants	1	Carriers	1
Company managers	6	Commercial travellers	1
Insurance agents	1	Housekeepers	1
Doctors	7	Florists	1
Dentists	2	Building contractors	1
Engineers	1	Bank officers	4
Journalists	3	Cartage contractors	1
Company directors	3	Retired railwaymen	1
Nurses	3	Woolbuyers	1
Typists	1	Garage proprietors	1
Storekeepers	1	Company representatives	2
Solicitors	8	Farm managers	1
Public servants	9	Contractors	2
Companies	3	Opticians	2
Widows	5	Manufacturers	1
Civil engineers	1	Publishers	1
Electrical engineers	1	Sports Dealers	1
Mechanics	2		
Retired nurses	2		178

Another factor which points towards the interest of the small investor in the share market is that the size of his average shareholdings in companies is decreasing. Figures supplied by three large companies are as follows:

	Average Shareholdings in £1 Units	
	1951	1954
Company X	852	690
Company Y	1,100	800
Company Z	257	248

The apparent discrepancy between the average order mentioned above and the average shareholding given above is explained by two factors, viz.:—

(1) Many of the Dominion's leading companies were at one time private businesses and in most cases there remain a few substantial family holdings which affect the averages.

(2) Many buyers "build up" on their holdings from time to time. This resembles buying by instalments but obviates liability.

It has been found that the small investor is attracted to the share market when "rights" to new issues come on the market. Usually these "rights" are not highly priced and in most cases the investor has the opportunity of meeting the "capital" portion of the payment required over a period of several months.

It has also been found that the small investor with about £100 to outlay will prefer to buy say one hundred shares at approximately £1 each instead of say three shares at £33 each. For this reason our members, whenever opportunity offers, suggest to the Directors of companies the shares of which stand at a high figure that such shares be subdivided in order to reduce the market value of each.

IV. THE PRICE OF CREDIT: INTEREST RATES SINCE 1934

Borrowing Rates

347. Immediately after the depression of the early 1930s interest rates fell appreciably, due to the economic circumstances of the time which produced a heavy dampening of the demand for investment. Government policy was then designed to maintain a cheap money policy as an encouragement to investment, and to stimulate economic recovery. The following is an extract from the Financial Statement of 1933: *"Experts do not altogether agree as to the causes of our troubles, but all are in agreement that cheap money is an essential element of recovery. Accordingly, while endeavouring to give relief for the present, the Government set out upon a campaign to bring about lower market rates of interest on a sound basis. It was considered that, if this could be achieved, it would be of much greater and more lasting benefit to all sections of the community than a simple cut in existing charges".* About that time approximately £115 million of the public debt was converted at lower rates of interest.

348. The 1934 Financial Statement contains a reference to the Reserve Bank which commenced business on 1 August of that year in these terms, *inter alia: "In the immediate future the bank will undoubtedly prove a powerful factor in furthering the Government policy of aiding economic recovery by stabilising interest rates at a lower level".*

349. Government long-term public loan issues between the years 1922 and 1932 were made at rates of interest varying between 5 and 5½ per cent. The conversion loan of 1933 was made in the main at 4 per cent. Subsequent issues between the years 1934 and 1939 were made at 3½ per cent and 4 per cent. Soon after the outbreak of the Second World War, the long-term rate for Government borrowing fell to 3 per cent, and continued at that figure until about 1950.

350. The war years, 1939–45, involved the country in heavy expenditure for war purposes, so that the maintenance of low interest rates for Government borrowing was regarded as a matter of national importance and was supported by patriotic impulses. In this period, fiscal policy was designed to limit the accumulation of private wealth and the interest returns thereon. Early in the war period the economy was subjected to rigid controls. Soon after the end of the war some of these controls were

released, but the majority were continued into the post-war period. The effect of the controls and of shortages of labour, materials, and equipment was to restrain capital expenditure in both the public and private sectors of the economy so that the effective demand for investment was never sufficient to put an undue strain upon the expanding money resources; consequently the general pattern of interest rates was maintained at a low level.

351. It is interesting now to look back at a statement made by the Government Insurance Commissioner in 1951 when, speaking of investments made in the calendar year 1950, he said that he regarded the full employment of the available funds as *"no light achievement in view of difficulties facing investors in a market where there is still no lack of idle money"*.

352. The dismantling of controls from about 1950 coincided with a marked rise in prices for our exports, and produced an unprecedented buoyancy in business conditions. The war and immediate post-war years had left a substantial backlog of desirable capital works which, together with the needs of a rapidly expanding economy, now began to exert heavy pressure upon the available resources, both physical and monetary. The effect on the money market is seen in a rise in the rate of interest on the Government loan issues in 1953 and 1954, from the earlier rate of 3 per cent to $3\frac{3}{4}$ per cent. Both issues were made at a discount and offered yields of £3 19s. per cent and £3 19s. 6d. per cent respectively. The Government loan of £10 million, which was opened for public subscription in October 1955, showed a return to investors of nearly $4\frac{1}{8}$ per cent after taking account of the terms of the issue. All loans issued by the Government since 1952–53 have ensured, by means of income-tax rebates, that investors would receive a minimum net return of 2 per cent on nominal value after payment of tax, and have offered investors the alternatives of taking up ordinary stock or death duty stock which would be available to meet income tax and social security charges in regard to deceased holders' estates, as well as death duties. These concessions, of course, add to the attractiveness of Government stock, particularly to the large investor.

353. The ruling rate for local body loan issues, which is generally about $\frac{1}{4}$ per cent above Government issues, was $4\frac{1}{4}$ per cent in 1939. In conformity with the stabilisation plan, this rate was reduced in 1942 to $3\frac{1}{4}$ per cent, and continued at that figure until October 1952 when it was raised to 4 per cent. For some time before the above increase was effected, local bodies had experienced considerable difficulty in obtaining loan moneys at $3\frac{1}{4}$ per cent. On 5 October 1955 a further increase in the rate to $4\frac{1}{4}$ per cent was announced following a similar difficulty to that referred to above.

354. The average rate of interest on mortgages registered during the years ending 31 March, which was 5·56 per cent for 1934, declined steadily, and had fallen by approximately 1 per cent by 1939, when it was 4·58 per cent. Thereafter the rate remained fairly steady at $4\frac{1}{4}$ per cent to $4\frac{3}{4}$ per cent until 1946 when a drop to approximately 4 per cent occurred. The rate continued at that figure for a period of six years. This latter fall appears to have been occasioned by the granting of a number of mortgages for rehabilitation purposes at 3 per cent interest. Since 1952 the average rate has shown a tendency to harden, reaching a figure of 4·69 per cent for the year ended 31 March 1955. The

operations of the State Advances Corporation of New Zealand, which is a Government-owned institution, have a considerable influence on the market for mortgage moneys as it is the largest lending institution in this field in the country. The total of the advances on mortgage by the Corporation current at 31 March 1955, and including accrued interest, was nearly £116 million. The interest rate charged, which remained constant at 4⅛ per cent for a number of years, was increased in 1954 to 4⅞ per cent, except for loans for the erection of new houses which remained at 4⅛ per cent. Although the average rate of interest on all mortgages registered during the year ended 31 March 1955 was 4·69 per cent, it is apparent that after making allowance for the extent of the lending on mortgages by the State Advances Corporation and the rates of interest which are charged by that body, the average rate for all other mortgages registered during that year would be about 5 per cent.

355. In 1941, agreement was reached between the Government and the trading banks to reduce the then existing rates of interest for advances on overdraft of a minimum of 4½ per cent and a maximum of 6½ per cent, to 4 per cent and 5 per cent respectively, and the latter have been continued right up to the end of 1955. In view of the increase that has taken place in other interest rates in recent years, bank loans are now the cheapest form of accommodation available to the community, more especially because interest on bank overdrafts is calculated on the daily balances of overdraft accounts, and because very little initial expense is incurred in arranging a bank overdraft. The highest rate of interest which the trading banks can charge for advances on overdraft is 5 per cent, which is about the same as the average rate of interest which other lending institutions are obtaining for advances on first mortgages of real property. The statistics of lending by the banks which appear in another section of this report show very clearly the heavy pressure to which they have been subjected for advances on overdraft.

Deposit Rates

356. Table 53 in Appendix H shows the changes that have occurred in the rates of interest which have been offered for deposits made with various types of institutions. In 1941 and 1942 these rates were reduced in keeping with the policy of cheap money which was instituted largely as a war measure. At that time the economy was subjected to rigid control in order to curb private spending. High interest rates were not needed to encourage savings, partly because the controls on spending made this unnecessary and partly on account of an urge to save prompted by patriotic motives and publicity.

357. It will be noted that rates of interest fixed for deposits in 1941 and 1942 remained unchanged for many years. The first alterations since that time were made in December 1952 when stock and station agents and trading companies were permitted to allow interest at 3¼ per cent on deposits for periods of four years and over. Prior to this change the limit was 3 per cent for deposits for a period in excess of three years. Building and investment societies were also granted, in 1952, an overall increase of about ½ per cent in rates for deposits up to two years. For deposits for a period of more than four years the rate was also increased from 3 per cent to 3¼ per cent. In 1954, these societies were granted a further increase in their long-term rates, from 3¼ per

cent to $3\frac{3}{4}$ per cent for a term of five to seven years, and to 4 per cent for a term in excess of seven years. In 1945 the trustee savings banks received authority to extend the then limit of £200, on which $2\frac{1}{2}$ per cent interest was payable, to £500. The limit was again raised in 1955 with interest at $2\frac{1}{2}$ per cent permitted up to £500, and 2 per cent from £500 to £750. In 1952 the limit in the Post Office Savings Bank was restored to £5,000, which had existed until 1 March 1935. Interest rates were fixed as follows: Up to £500, $2\frac{1}{2}$ per cent; £501 to £2,000, 2 per cent; £2,001 to £5,000, $1\frac{1}{2}$ per cent. At the same time, the maximum amount that could be deposited in a national savings account in any year was raised from £1,000 to £2,000. The alterations in the limits of deposits in both the trustee savings banks and the Post Office Savings Bank did not involve any increase in the maximum rate of interest allowed.

V. CONTROL OF CREDIT

358. We have examined in Part II of Section One of this Appendix the means adopted to control trading-bank credit, and in Part III of Section Two the Government's fiscal policies which determine the extent to which it needs to borrow from the Reserve Bank. Policies which restrain or reduce the volume of money tend to reduce the volume of credit which can be extended by non-banking institutions or persons. Transactions must be settled in money and therefore the current volume of saving and the extent to which existing money can be borrowed, places an upper limit on the amount of lending which is possible.

359. Accordingly, with many forms of credit, a tightening of trading-bank credit will cause businesses which rely on bank credit to reduce the amount they have outstanding with their own customers. However, many of the non-banking sources of credit, and particularly those institutions which extend longer-term credit for investment purposes as distinct from consumption, are not subject, except indirectly, to any influence of bank credit. Their funds come from repayment of former loans, from deposits, or from contractual saving.

360. The controls and shortages during the war and early post-war periods which held down the demand for bank credit operated also to reduce the demand for, and to some extent the supply of, other forms of credit.

361. Certain direct controls over borrowing by various groups have probably also held down the demand for credit to some extent during the period reviewed. The main controls are outlined below.

Control of Local Body Borrowing

362. Borrowing by local authorities has been controlled through the Local Government Loans Board. The Board was set up in 1926, after a period of heavy borrowing by local authorities, some of which had given insufficient attention to their ability to undertake and discharge the liabilities which they had assumed. The Board comprises the Secretary to the Treasury and the Commissioner of Works (both ex officio) and five other persons appointed by the Governor-General. Since 1926 local authorities have been required to obtain the sanction and approval

of the Board to all proposals for raising loans. The Board was empowered to fix the rate of interest on all local body loans, subject to the proviso that the rate as fixed must not exceed the maximum rate determined for the time being by the Minister of Finance.

363. In general, the Board does not appear, until fairly recently, to have reviewed loan proposals in relation to the complete investment programme, public and private, of the country. In 1955, however, it was directed by the Minister of Finance to have regard, in deciding whether or not to grant applications to raise loans, to the essentiality of the projects concerned.

The Capital Issues Committee

364. The control of capital issues dates from 1940, when extensive powers were vested in the Minister of Finance under the Finance Emergency Regulations 1940, the object being to divert as much money and productive power as possible to the war effort. Some relaxation of the controls imposed by these regulations was made in 1946 by exempting from control the formation of new companies with a capital not exceeding £10,000 and issues of capital by any existing company not exceeding in the aggregate £10,000 in any year. Issues of capital include mortgages and debentures.

365. In April 1952, because of heavy pressure on the capital market, the Capital Issues Committee was set up to administer the regulations, and the powers vested in the Minister of Finance were delegated to the Committee. Control by the Committee extends to the following:

(a) The formation of new companies with a nominal capital exceeding £10,000.

(b) Increases of nominal capital of existing companies in excess of £10,000 in any year.

(c) Calls on shares and issues of capital (including mortgages and debentures) where the amount of the proposed call or issue of capital, together with the amount of all other calls or issues made by the company within the preceding year, exceeds £10,000.

(d) The commencement of business in New Zealand by companies incorporated overseas.

366. The maximum rates of interest fixed by the Committee in 1952 for issues of capital were:

Mortgages: $4\frac{1}{4}$ per cent.
Debentures: 5 per cent.
Preference shares: 5 per cent (in some cases with participating rights).

367. Subsequent alterations were made in rates for mortgages only as follows:

August 1952, increased to a maximum of $4\frac{1}{2}$ per cent.
February 1955, increased to a maximum of $4\frac{3}{4}$ per cent.
October 1955, increased to a maximum of 5 per cent for mortgages between £10,000 and £20,000 only.

368. The following is a summary of the decisions of the Committee on applications involving new finance:

(£ million)

Calendar Year	Applied for	Approved	Declined or Deferred
1952 (April to December)	14·9	9·1	5·8
1953	12·0	8·8	3·2
1954	21·4(1)	18·0(1)	3·4
1955 (January to September)	15·9	9·0	6·9

(1) Includes £4·3 million issued by Tasman Pulp and Paper Co. Ltd. but excludes issues by that company to the Government.

Control of Hire-purchase Transactions

369. On 21 July 1955 the Minister of Finance, in his Budget speech, announced the Government's intention of controlling future hire-purchase business in the Dominion.

370. The relevant extract from the speech reads as follows:

A factor which has contributed to the high levels of spending and imports has been the growth in hire-purchase transactions. Hire-purchase regulations have been used successfully in overseas countries to limit spending on consumer goods. After careful consideration the Government has decided to introduce such regulations in New Zealand. These regulations are being gazetted tonight. They provide for minimum deposits and maximum periods for payment of the balance under hire-purchase agreements and credit sale agreements as follows:

—	Minimum Percentage of Cash Price	Maximum Period for Payment of Balance
Motor vehicles	50 per cent	18 months
All other goods	15 per cent	24 months

Subsequently the minimum deposits required for the purchase of trucks were reduced to 33⅓ per cent.

Control of the Level of Interest Rates

371. All of the above controls, in so far as they succeed in reducing the demand for credit, tend to hold down the level of interest rates.

372. When the Government obtains part of its financial requirements by public borrowing it must offer a rate of interest in keeping with market conditions. However, it obtains some funds annually from State Departments and institutions. The Government is able to exercise an influence on the rate of interest which it pays for some of these loan moneys, and the availability of loan moneys from departmental sources reduces its demands on the open market and, on occasions, enables the Government to refrain from entering the open market.

373. In the 1952–53 financial year, for instance, the Government refrained from entering the market because of the large unsatisfied demand for local body and private needs. In that year the Government obtained a substantial part of its requirements, apart from departmental investments, by using certain of its cash reserves, and the balance was borrowed from the Reserve Bank.

374. By maintaining the rate of interest charged by the State Advances Corporation at a relatively low level, the Government can also influence to some extent the general level of interest rates on mortgages.

375. Finally, as indicated above, although there has been some relaxation of controls over interest rates, there is still a wide range of rates which are subject to regulation. The latter are briefly summarised hereunder, together with maximum rates ruling at December 1955:

(a) *Lending Rates*—

(i) Issues of capital by limited liability companies where the amount of the issue in any year exceeds £10,000 such as:

Mortgages: Maximum rates, $4\frac{3}{4}$ per cent (5 per cent for mortgages between £10,000 and £20,000).

Debentures: Maximum rate, 5 per cent.

Prefernce shares: Maximum rate, 5 per cent (in some cases with participating rights).

(ii) Local bodies: Maximum rate, $4\frac{1}{4}$ per cent.

(iii) Bank overdraft rates: Maximum, 5 per cent; minimum, 4 per cent.

(iv) State Advances Corporation of New Zealand—

For advances on first mortgage (other than for erection of new house), $4\frac{7}{8}$ per cent.

For erection of new houses, $4\frac{1}{8}$ per cent.

(Note.—Some of the above interest rates have been increased since 31 December 1955.)

(b) *Deposit Rates*—Maximum rates payable on deposits made with the following institutions are subject to control and will be found in Appendix H:

Post Office Savings Bank.
Trustee savings banks.
Local bodies.
Stock and station agents and trading companies.
Building and investment societies.

The deposit rates paid by the trading banks are to some extent governed by the rates charged on overdrafts, which are subject to control by agreement with the Government.

Appendix D

PART I

Opinion of the Solicitor-General on the Subject of the "Creation of Credit" by the Trading Banks

The legal aspects of money are discussed in Halsbury (3rd Edition), Vol. 7, pp. 303–4, para. 646, in the following terms:

The tokens known as "money", which constitute a legal medium of exchange, consist in England either of coins made and issued by the Crown under the exclusive powers it enjoys at common law, which are now for the most part regulated by statute, or of bank notes made and issued by the Bank of England under statutory powers;

and in a footnote to this passage the following statements appear:

(q) At common law the Crown enjoys the exclusive right of making and issuing money, though formerly this right was frequently granted out as a franchise and could be claimed by prescription; but in all cases the impression or stamping of coins was the King's prerogative, and the grantees of the franchise had usually the stamp sent to them by the Exchequer (1 Bl. Com (14th Edition) 277). The denomination or value at which the coin was to pass current was also determined by the King in all cases, though he could not, it seems, debase or enhance the value below or above the sterling value (ibid., 277, 278; 2 Co. Inst. 577; but as to enhancing or debasing the coinage, see *contra* 1 Hale, P.C. 194). These prerogative rights still exist, but have for the most part been placed upon a statutory basis; . . . Where no statutory provision has been made, the Sovereign, with the advice of the Privy Council, is empowered by proclamation to regulate any matters relating to the coinage and the Mint within the present prerogative of the Crown, and to revoke or alter any proclamation previously made (Coinage Act, 1870 (33 & 34 Vict. c. 10), s. 11 (10), (11)). Every such proclamation comes into force on the date therein mentioned, and takes effect as if enacted by the Coinage Acts, 1870 to 1946 (ibid., s. 11).

This branch of the law is also referred to at some length in 1 Blackstone's *Commentaries* 276–278 and in Chitty's *Prerogatives of the Crown*, pp. 196–199; and in Holdsworth's *History of English Law*, Vol. X, pp. 407–411, the Royal Prerogative in respect of monetary matters is dealt with from an historical point of view.

I think that it is clear from all these authorities that the Royal Prerogative in question relates primarily, if not exclusively, to the regulation of the coinage and that at the most it is confined to the creation and issue of "money proper" or "State money" (Cf. the classification of money and the expressions used in Keynes' *Treatise on Money*, Vol. 1, pp. 5 *et seq*).

The prerogative of the Crown in respect of monetary matters has in my opinion no application whatever to the creation and issue of "credit", i.e., "Bank-money or Acknowledgments-of-Debt", the historical origins of which are to be found not in the common law itself but in the Law Merchant (see Holdsworth's *History of English Law*, Vol. VIII, pp. 113 *et seq*). The correctness of this view is indirectly supported and confirmed by the decision of the Privy Council in *A.G. for Alberta* v. *A.G. for Canada* (1947), A.C. 503, in which the Board in respect of the main issue involved in the case affirmed the unanimous judgment of the Appellate Division of the Supreme Court of Alberta.

In this case the question at issue was the validity of certain legislation passed by the "Social Credit" Government of Alberta. Part I of the Alberta Bill of Rights Act 1946 enumerated and declared certain rights of Alberta citizenship, including the right to the opportunity to engage in gainful employment, or, if that was not available, to a social security pension, and to receive the necessities of life adequate to ensure health and physical well-being, educational and medical benefits, and retirement pensions. In Part II the Act set up machinery for expressing in monetary terms the natural, economic, and human wealth and resources of the Province, and for utilising credit deposits resulting therefrom in payment of the social security pensions and other benefits specified in Part I. Provision was made in Part II for the licensing by a Board of Credit Commissioners of all credit institutions which admittedly included chartered banks, carrying on business within the Province, and for issuing to them Alberta Credit Certificates against which such institutions were to issue to customers, or create in their favour, "credit deposits" over and above the deposits against which a reserve of currency was held; for the transfer of customers' credit deposits; and generally for regulating the creation, expansion, and contraction of, as well as all dealing in, credit where such credit was not based on a reserve of currency of an equivalent value, and for that purpose compulsorily to recruit the services and facilities of existing credit institutions.

It was held by the Privy Council that it is not beyond the business covered by the word "banking" to make loans which involve an expansion of credit, and accordingly Part II of the Act, which aimed at restricting and controlling that practice, was in pith and substance legislation relating to "banking", a subject matter within the exclusive legislative competence of the Parliament of Canada under head 15 of section 91 of the British North America Act 1867, and, accordingly beyond the powers of the Provincial legislature to enact.

The following contentions, *inter alia,* were made to the Board on behalf of the Appellant Government:

. . . Part II does not deal with "banking" within the meaning of that word as used in the British North America Act at the time of confederation, and consequently the control of the issue and creation of credit by the chartered banks over and above their cash reserves is within the legislative competence of the Province . . . While it is conceded that banks deal with credit as part of ordinary banking operations, it is contended that the practice which the banks have assumed of expanding credit over and above their cash reserves did not constitute the practice at the time of confederation, is not banking practice within the meaning of that word in the British North America Act, and is not in conflict with any provision of the Dominion Bank Act, and that consequently there is a field reserved to the Provinces under the general heading of "property and civil rights", and the Province may legislate in this field even though it affects banking operations. That is the broad submission. The Appellant must first bring himself within s. 92 of the Constitution Act, and he must also show that the Act in question does not relate to "banking" and that it does not infringe on any other sub-head of s. 91.

"Credit" extends far beyond the legitimate province of banking; jurisdiction in regard to credit is inseparable from jurisdiction over "property and civil rights," and jurisdiction over credit is neither exclusively nor by necessary implication reserved to the Parliament of Canada in the Act of 1867. The financial credit of the Province is the ability and intention of the people to produce goods and services. (The history of banking was then dealt with to show the relationship which existed between credit and banking, and reference was made to the practice at the time of confederation, and to Breckenridge, *Canadian Banking System,* p. 243, and to Curtis on *Statistical Contributions to Canadian Economic History – Statistics of Banking*). The foregoing establish that at the time of confederation banks had not then assumed the practice of expanding credit as they are doing today . . . It is a function which cannot be recognised as coming within the field of Dominion legislation. Although banking is properly a dealing in credit, it cannot be said that all dealing in credit is banking – that is the crux of the argument . . . The term "banking" as used in s. 91, head (15) of (the British North America Act) should not be given a more extended meaning than that which it had at the passing of the Act . . . It then had a definite and specific meaning, and the Dominion Parliament could not legislate with respect to matters not ordinarily included in the term banking at that time – which did not include expanding credit – and those matters would otherwise be included under the head "property and civil rights" and within the jurisdiction of the provincial legislatures (1947 A.C. at pp. 505–7).

In rejecting these contentions their Lordships in the course of their judgment (at pages 517–8) said:

The concept of banking certainly includes the granting of credit by banks; "a banker", as Duff C. J. said in dealing with the *Alberta Legislation Reference* ((1938) S.C.R. (Can) 100, 116) "has been defined as 'a dealer in credit.'" Whether the expansion of credit now effected by bankers' advances is regarded as wise or unwise, as just or unjust, as economically desirable or economically unjustifiable does not, in the view of their Lordships, affect the point here at issue at all. If it is fairly included within the conception of "banking" it is a matter exclusively reserved for the legislature of Canada.

In the well-known decision of the Privy Council in *Tennant* v. *Union Bank of Canada* (1894 A.C. 31, 46), Lord Watson laid it down that the head "banking" was an expression "wide enough to embrace every transaction coming within the legitimate business of a banker". He further said that, notwithstanding that "Property and civil rights" was a topic allocated to the provincial legislatures under s. 92, "banking" was one of the matters concerning which the exclusive legislative authority of the Parliament of Canada could not be operated without interfering with and modifying civil rights in the Province. This view of the width of the expression "banking" has been recently confirmed by another decision of this Board in *Attorney-General for Canada* v. *Attorney-General for Quebec* (1947 A.C. 33). Undoubtedly the business of banking has developed and expanded greatly since Confederation, though it is by no means clear that even before 1867 banks in Canada were not practising to a more limited extent the kind of operation which it is the object of the Alberta Act now under consideration to prevent or restrict. Harvey C.J. points out that as early as 1859 the legislature of the then Province of Canada was enacting (s. 1. of c. 55 of the Consolidated Statutes of that year): "The business of banking shall, for the purposes of this Act, mean the making and issuing of Bank Notes, the dealing in gold and silver bullion and exchange, discounting of promissory notes, bills and negotiable securities, and such other trade as belongs legitimately to the business of banking." Moreover, s. 85 of that Act provided that "the total liabilities of any Joint Stock Bank shall never exceed three times the amount of its capital" – a provision which sets some limit to bank lending, but not a limit measured by the currency which the bank holds. But in any event, it appears to their Lordships to be impossible to hold that it is beyond the business covered by the word "banking" to make loans which involve an expansion of credit. Legislation which aims at restricting or controlling this practice must be beyond the powers of a provincial legislature.

In New Zealand the trading banks operate under and subject to the provisions of the Banking Act 1908. Section 3 of that Act provides that "all Royal charters and letters patent granted or to be granted by His Majesty to any bank shall to all intents and purposes be as effectual within New Zealand as Acts of the General Assembly thereof". In section 2 "charter" of a bank is defined as meaning "the Act of Parliament, Royal charter, letters patent, deed of settlement, memorandum of association, or other instrument by or under which the bank is incorporated; and includes all amendments of such instrument, and also all articles of association, by-laws, rules, and regulations providing for the administration and management of the bank"; and "bank" is defined as meaning "any person, partnership, corporation, or company *carrying on in New Zealand the business of banking*".

I do not think that there can be any doubt that the "creation of credit" is a legitimate function of a trading bank which has been duly authorised to carry on the business of banking in New Zealand and that in performing this function such a bank is in no way invading or usurping the prerogative of the Crown or infringing any other principle or rule of law.

PART II

Extracts from Authorities Regarding Creation of Bank Deposits, i.e., "Creation of Money"

1. "The Early History of Banking", an article in the *Law Quarterly Review,* January 1918, Vol. 34, page 13:

A promise by a banker of good repute to pay on demand was as good as money and was taken as money. Thus in 1584 Contarini said that a banker could accommodate his friends without payment of money merely by writing a brief entry of credit, and that he could "satisfy his own desires for fine furniture or jewels by merely writing two lines in his books". Thus, to use modern terms, the Italian banks had become not only banks of deposit, but also banks of issue.

2. Macleod, *The Theory of Credit,* 2nd Edition, 1894, page 582:

In former times there were many persons who acted as intermediaries between persons who wanted to lend and those who wanted to borrow. They were called Money Scriveners. The father of John Milton was a Money Scrivener. But no one ever called a Money Scrivener a Banker.

At the present day many firms of Solicitors act as intermediaries between persons who wish to lend and others who want to borrow. They may have some clients who wish to lend, and other clients who want to borrow: and they act as agents between them. The first set of clients may entrust their money to the firm to lend to the second set: and the solicitors receive a commission on the sums which pass through their hands. But no one ever called a firm of solicitors who transact such business "Bankers": which shows that there is an essential distinction between the business of Money Scriveners and such a firm of Solicitors, and the business of "Bankers".

Page 584:

A "Banker" is therefore a person who trades in the same way that the Public Banks did: they acquired the Property in the money paid in: and in exchange for it they gave Bills of Credit: which circulated in commerce exactly like money: and produced all the effects of Money. And moreover when they bought or discounted, Bills of Exchange, they did it exactly in the same way: they bought them by issuing their own Credit: and Not with Money. And experience showed that they might multiply their Bills of Credit several times exceeding the quantity of money they held: and thus for all practical purposes multiply the quantity of Money in circulation. Thus the essential business of a "Banker" is to create and issue Credit to circulate as Money.

Page 585:

The following is the true definition of a "Banker"

"A Banker is a Trader who buys Money and Credits, Debts, or Rights of action payable at a future time by creating and issuing Credits, Debts, or Rights of action payable on demand."

Page 607:

Having now given an exposition of the actual facts and mechanicism of Banking, it will be as well to contrast the Common Notions respecting it and the Reality.

I. It is commonly supposed that Bankers are dealers in Money only, that they borrow Money from one set of persons and lend it to another set of persons.

The fact is that Bankers are not dealers in Money: they never lend Money. The sole function of Banker is to create and issue Credit: and to buy Money and Debts by creating and issuing other Debts in exchange for them.

II. It is commonly supposed that Bankers act only as agents or intermediaries between persons who want to lend and those who want to borrow. Bankers never act as agents between persons who want to lend and those who want to borrow. Bankers buy money from some persons: and Rights of action from others: exclusively with their own Credit: or by creating and issuing Rights of action against themselves.

3. D. A. Barker, *Cash and Credit,* 1st edition 1910, reprinted 1912 and 1920, page 8:

We must now consider the nature of the business transacted by a typical banking institution situated at a monetary centre such as that described in the last chapter; and for such information we turn naturally to the balance sheets periodically issued by the bank for the benefit of the public. These balance sheets, however, contain on both sides details which are not essential to the limited scope of this chapter and which may, therefore, for our present purpose, be omitted. In its most simplified form the balance sheet may be represented as follows:

Liabilities	£	*Assets*	£
Deposits of customers ..	20,000,000	Cash	4,000,000
		Investments	2,000,000
		Loans to customers ..	14,000,000
	£20,000,000		£20,000,000

To avoid the complications which would arise if we had to consider transactions between many different banks, we will suppose that this represents the consolidated balance sheets of all the banks at our monetary centre; the items shown here being simply the totals of similar items in the individual balance sheets. The total liability of all the banks, then, amounts to £20,000,000, and against this liability they can show £4,000,000 of actual cash, £2,000,000 invested in securities, and £14,000,000 lent to customers.

Firstly, then, as to the item "deposits of customers". To the average non-commercial man a bank is merely an agency for keeping his spare cash and for collecting the money due on cheques payable to him. For him a "deposit" really is a deposit, and the use of such a word naturally leads him to believe that the sum of £20,000,000 entered under this description has actually been deposited in the banks by their customers. But the nature of his mistake is revealed by considering the case of the commercial man who wishes to borrow from a bank. This would-be borrower, we will suppose, is an enterprising man and asks for a good round sum, say, one million sterling; in which request the bank manager good-naturedly acquiesces. Having obtained his loan the borrower has to decide what to do with it. He might, in very unusual circumstances, ask for cash down, but, as a general rule, the bank will give him a credit on its books, and he will draw cheques against that credit as necessity arises. What will be the effect of this transaction on the balance sheet? If he asks for cash the item "cash" will be reduced by one million sterling and the item "loans to customers" will be increased by a similar amount, thus:

Liabilities	£	*Assets*	£
Deposits of customers ..	20,000,000	Cash	3,000,000
		Investments	2,000,000
		Loans to customers ..	15,000,000
	£20,000,000		£20,000,000

But if he merely accepts a credit in the bank's books the change will be as follows:

Liabilities	£	*Assets*	£
Deposits of customers ..	21,000,000	Cash	4,000,000
		Investments	2,000,000
		Loans to customers ..	15,000,000
	£21,000,000		£21,000,000

In this latter case we see that there has been a change on both sides of the account, and that the items "deposits of customers" and "loans" have both been increased to the extent of one million pounds. This is, then, the important point, that a loan by the bank to a customer increases the item "deposits" and that "deposits" therefore are not made up, as they might seem to be, merely of idle balances and savings, but also of credits given by the bank.

4. Henry Clay, *Economics for the General Reader*, 1916, page 190:

If, for example, I deposit five hundred sovereigns with a bank, the bank can immediately lend them to somebody else; if I receive a credit of £500 and give as security my life-insurance policy, the bank can do nothing with that, so long as I satisfy the conditions on which the credit was granted. But whether a bank's client has acquired the right to draw cheques on the bank by depositing wealth with the bank or by receiving an advance from it, he has that right; the bank undertakes to honour cheques signed by him, i.e. to pay cash for them if asked to do so. An account which gives this right to draw cheques, however acquired, is a "Current Account." Banks will also receive money on deposit and pay interest on it, on condition that it is not withdrawn without the giving of some days' notice; an arrangement of this kind is a "Deposit Account."

Suppose a bank has made an advance of this kind; the bank's client will wish to use the advance, and will use it by drawing cheques to the amount of the advance to pay his creditors. Now his creditors in nine cases out of ten will not cash these cheques, but will pay them into their banking account as deposits; thus the advance made by one bank becomes a deposit in another bank, or, it may be, in the same bank. If the creditor to whom the bank's client pays the cheques which he draws against his advance has an account with the same bank, the bank has merely to make two entries in its books, deducting the amount of the cheque from one account and placing it to the other; if the cheques are paid into some other bank, they will be set against cheques drawn on this other bank and paid into the first bank, when the representatives of the two banks meet in the Clearing-House. Thus while deposits or advances are distinct from the point of view of the individual client or bank, from the point of view of the banking system as a whole deposits and advances are largely identical.

We can see now how banks are able to "manufacture credit," we might almost say "manufacture money." At first they accepted deposits of gold and loaned them out again, acting merely as middlemen between those who had and those who wanted cash. Now they accept deposits which they loan out again, and in addition make advances which have no deposits against them, by creating claims on themselves which their clients can transfer in payment for their purchases. The bank makes an advance to a client of £1000; this means that it undertakes to meet the claims for gold on its client to the amount of £1000; it has increased its liabilities by £1000 and this will appear in its balance sheet in the form of an additional £1000 added to its Current and Deposit Accounts, while there is a corresponding increase in its assets appearing in the balance sheet in the form of £1000 added to its Advances to Customers on Security. When a bank makes an advance of £1000 a mutual liability is created between the bank and its client; the bank incurs a liability to find 1000 sovereigns if called on, and the client incurs a liability to repay the bank £1000 when called on. The bank can incur this liability only because it is never called on to meet it in full; the clients to whom it makes advances draw cheques against those advances to pay their debts, but the cheques are never all presented for cash payment; most of them always are paid into other banks as deposits and are cancelled against cheques on these other banks, which are paid into the first bank as deposits.

A bank can safely make advances because those advances will most of them become deposits in other banks, just as its own deposits consist largely of claims on other banks which have made advances to their clients.

5. B. E. Murphy, *Outlines of Economics*, 1924, page 432:

A banker's deposits are of a twofold nature, consisting not merely of cash deposited by the community (Sec. 93 (3) (b)), but also of credits created by the bank and subject to withdrawal by cheque. Suppose, for instance, that a business man discounts a bill with his banker, or otherwise makes arrangement to draw on the bank, either on personal security or by the deposit of collateral, and is granted an overdraft to the extent of £1,000. He thereupon draws a cheque for this amount and pays it to his creditor, who in turn deposits it to his credit at his bank. The net result of the loan is to swell deposits or diminish debits either at the bank which grants . . . the loan, or at some other bank, by the amount of the cheque drawn. Bankers' deposits, therefore, are made up not merely of actual deposits of cash lodged with the banker, which is the popular idea of their nature, but also of loans granted by the same or any other bank, as soon as they are operated on by cheque and the cheque is in turn deposited; the banks thus creating claims on themselves which are readily accepted as currency by the business world.

Once credits are created in a banking system, they can never be extinguished, unless they be permanently withdrawn in legal tender, which remains in circulation or is hoarded or sent abroad, or they are absorbed in liquidation of bank loans, public or private. (Kirkaldy: *British Finance:* 1914–1921, p. 143.)

6. "Committee on Finance and Industry" (U.K.), 1931, (Macmillan Report), page 34:

It is not unnatural to think of the deposits of a bank as being created by the public through the deposit of cash representing either savings or amounts which are not for the time being required to meet expenditure. But the bulk of the deposits arise out of the action of the banks themselves, for by granting loans, allowing money to be drawn on an overdraft, or purchasing securities a bank creates a credit in its books, which is the equivalent of a deposit. A simple illustration, in which it will be convenient to assume that all banking is concentrated in one bank, will make this clear. Let us suppose that a customer has paid into the bank £1,000 in cash and that it is judged from experience that only the equivalent of 10 per cent. of the bank deposit need be held actually in cash to meet the demands of customers; then the £1,000 cash received will obviously support deposits amounting to £10,000. Suppose that the bank then grants a loan of £900; it will open a credit of £900 for its customer, and when the customer draws a cheque for £900 upon the credit so opened that cheque will, on our hypothesis, be paid into the account of another of the bank's customers. The bank now holds both the original deposit of £1,000 and the £900 paid in by the second customer. Deposits have thus increased to £1,900 and the bank holds against its liability to pay out this sum (a) the original £1,000 of cash deposited and (b) the obligation of a customer to repay the loan of £900. The same result follows if the bank, instead of lending £900 to a customer, purchases an investment of that amount. The cheque which it draws upon itself in payment for the investment is paid into the seller's bank account and creates a deposit of that amount in his name. The bank, in this latter case, holds against its total liability for £1,900 (a) the original £1,000 of cash and (b) the investment which it has purchased. The bank can carry on the process of lending, or purchasing investments, until such time as the credits created, or investments purchased, represent nine times the amount of the original deposit of £1,000 in cash.

The process is much the same when we remove the assumption that there is only one bank. The credit granted by one bank may reach the accounts of customers in another bank. There is thus established a claim by the second bank upon the first for cash, and the ability of the second bank to grant loans is improved in so far as that of the first bank is reduced. Over the banking system as a whole therefore, loans and investments made by the banks increase their deposits. There is, however, a limitation on this process. A bank which is actively creating deposits in this way will naturally find that a considerable part of the cheques drawn against them will be in favour of other banks. It will thus lose part of its cash reserve to those banks and must proceed to limit its loan operations if its normal cash ratio is to be maintained. In practice, therefore, no one bank can afford to pursue a policy of creating deposits by making loans or investments which is much out of line with the policies of other banks.

7. "Report of Royal Commission on Monetary and Banking Systems" (Australia), 1937, page 193:

To explain the effects which the making and repayment of bank advances have upon bank deposits, it is convenient to trace what would happen if the whole business of the trading banks were concentrated in a single bank. When an advance is granted, the borrower is authorised to draw cheques upon the bank. Some of the cheques so drawn will be paid in as deposits to the bank by other people. Other cheques will be paid in cash, for example, cheques to pay wages, etc. But much of the cash so obtained will, when spent, be paid in as deposits to the bank, for example, by storekeepers. (In a selected week in 1936, 88 per cent. of the amount paid into trading banks in Australia was in the form of cheques, and 12 per cent. in the form of notes and coin.) In this way the money advanced by the bank will tend to return to the bank in the form of deposits. The increased deposits provide a source from which further advances can be made, and the general tendency of an expansion of advances is to increase the deposits. But the process does not increase the bank's cash reserves, and the limit of expansion is set by the necessity for maintaining adequate cash reserves.

It is obvious that this process of expansion requires customers who deposit, and customers who borrow. The bank cannot lend unless credit-worthy borrowers are forthcoming, nor extend its lendings, unless the loans are returned to the bank as deposits.

In practice the whole of the loans will not invariably return as deposits. There are several reasons why this would not happen. In the first place, the cheques drawn by the borrower may be used to repay, or reduce, an existing advance. In this case, the loan has had no effect upon the total of advances, and has no effect on the deposits. The liability to the bank has merely been transferred from one borrower to another. Secondly, when a cheque is cashed, for wages or other purposes, there is no certainty that all the cash will find its way back into the bank as a deposit. Some of it may be held by the public as money in circulation. In times of prosperity there is a tendency for the public to hold more cash. And thirdly, there is the possibility that the borrower may use his advance to pay for imports, and that the bank has to provide for this out of English money which it holds in London. As this English money is part of the bank's cash reserves the effect of the advance, in this case, is the same as if the bank had paid out cash which will not reappear as a deposit. It follows that it could never be said of any particular advance that it must necessarily affect the deposits. What could be said is that within certain limits the bank, by increasing its advances would, in the course of time, build up its deposits.

8. J. L. Hanson, *Money,* 1953, page 42:

Assuming that Black can find some sort of collateral security acceptable to his bank manager, and that he is agreeable to the bank's terms – the period for which the bank is willing to grant the loan and the rate of interest – Black can now obtain his loan of £500 from the bank. This can be by means of either a loan account or overdraft. If Black obtains a loan account, he borrows a fixed sum – £500 in this case – and interest on the whole of this amount at the agreed rate will commence immediately. If Black obtains an overdraft for £500, it means that he will be allowed to draw cheques up to a maximum of £500 over and above the amount standing to his credit in his current account, but in this case he will pay interest only on the actual amount by which his account is overdrawn.

Whichever method of borrowing he chooses, the result will be the same from the point of view of the quantity of money. In either case (if Black takes full advantage of his overdraft) the bank creates £500 of purchasing power for Black, for when a bank grants a loan to a customer, it is not necessary for it either to hand over to the customer or set aside for his use the sum of £500 in cash, as an ordinary moneylender would have to do. All that the bank has to do is to make a note of the loan or the overdraft to ensure that when Black's cheques are presented they will be honoured.

Of course, if borrowers always required their loans in cash, a bank could only lend cash that had previously been deposited with it. Since most people are like Black and only want to be able to make payments to their creditors by cheque, it becomes possible for banks to create what they lend. Let us suppose that Black, having obtained his overdraft, writes out a cheque for £500 in favour of White as payment for some raw material he has received from him. White will pay this cheque into his banking account, so that the deposit standing in his name will be increased by this amount. Because Black's bank has granted him an overdraft it will honour his cheque when it is presented, although Black has not sufficient funds in his account to meet it. After the cheque has been cleared, Black's account may show that he has nothing standing to his credit, exactly as was the case before he drew the cheque, whereas White's account has increased by £500. Total deposits have, therefore, increased by this amount. Thus loans create deposits. By expanding or contracting their advances to customers, banks can alter the total volume of bank deposits, and since bank deposits can be used as purchasing power, the willingness or otherwise of the banks to grant loans determines how much of this type of money there shall be.

But, it may be argued, will not the repayment of the loan by the customer again reduce the volume of bank deposits to the level at which they stood before the loan was granted: This would be so if only a single loan was involved and if this was repaid at the end of (say) three months. The majority of bank loans are renewed and new loans are constantly being granted as others are being repaid, so that over a long period of time there has been a tendency for bank advances to increase, as the following table shows:

BANK ADVANCES

	£ millions
1935	769
1938	976
1947	1,107
1950	1,603
1951	2,016

When a bank purchases Government Stock (this comprises most of the item "Investments" in the banks' balance-sheets), it pays with a cheque drawn on itself; so that when the people who have sold the stock – the Government itself in the case of a new issue or other investors in the case of existing ones – pay these cheques into their accounts, total bank deposits increase by an equivalent amount. When therefore a bank increases its investments, the effect is similar to that produced when it increases its advances to customers: both increase total bank deposits; that is, the quantity of money. The general policy of the banks is to increase investments when they cannot find a sufficient number of borrowers who are acceptable to them, and to reduce their investments when they wish to increase their advances.

The banks, however, do not possess unlimited power to create money. A banker, if he is to retain the confidence of his depositors, must always be able to pay cash to any of them on demand.

9. Paul A. Samuelson, *Economics – An Introductory Analysis*, 3rd Edition, 1955, page 272:

Can Banks Really Create Money?

We now turn to one of the most interesting aspects of money and credit, the process called "multiple expansion of bank deposits". This is little understood. Most people have heard that in some mysterious manner banks can create money out of thin air, but few really understand how the process works.

Actually, there is nothing magical or incomprehensible about the creation of bank deposits. At every step of the way, any intelligent person can follow what is happening to the banks' accounts. The true explanation of deposit creation is simple. What is hard to grasp are the false explanations that still circulate.

According to these false explanations, the managers of an ordinary bank are able, by some use of their fountain pens, to lend several dollars for each dollar left on deposit with them. No wonder practical bankers see red when such power is attributed to them. They only wish they could do so! As every banker knows, he cannot invest money that he does not have; and money that he invests in buying a security or making a loan soon leaves his bank.

Bankers, therefore, often go to the opposite extreme. They sometimes argue that the banking system cannot (and does not) create money. "After all," they say, "we can invest only what is left with us. We don't create anything. We only put the community's savings to work." Bankers who argue in this way are quite wrong. They have become enmeshed in our old friend, the fallacy of composition: what is true for each is not true for all. The banking system as a whole can do what each small bank cannot do: it can expand investments many times the cash given it.

Our answer then to the basic question is in the affirmative. Yes, the banking system and the public do, between them, create about five dollars of bank deposits for every dollar taken out of circulation and left in the banks.

Page 283:

7. Bank Demand deposits serve as a medium of exchange and a store of value; they are considered, therefore, to be money.

8. If banks kept 100 per cent cash reserves against all deposits, there would be no creation of money when currency was taken out of circulation and deposited in the banking system. There would be only a 1 : 1 exchange of one kind of money for another kind of money.

9. Modern banks do not keep 100 per cent cash reserves against deposits. In 1955 members of the federal reserve system are required to keep, on deposit with the regional Federal Reserve Bank, legal reserves equal to 20, 18 or 12 per cent of demand deposits, depending on city size.

10. Consequently, the banking system as a whole – together with public or private borrowers and the depositing public – does create deposit money almost 5 : 1 for each new dollar taken out of circulation and left on deposit somewhere in the system.

11. Each small bank is limited in its ability to expand its investments. It cannot lend or invest more than it has received from depositors: it can lend only about four-fifths as much. Its deposits are five times its cash, only because its cash decreases and not because its deposits increase. But it does create 1 of bank money for the $1/5$ of reserves it retains.

12. The system as a whole can expand at once as each small bank cannot. This can be seen if we examine a monopoly bank in a closed community. The checks written by such a bank always come back to it; therefore the only restriction upon its ability to expand its investments and deposits (its assets and its liabilities in double-entry bookkeeping) is the requirement that it keep one-fifth cash reserve ratios against deposits. When deposits have expanded until they are five times the increase of reserves, the monopoly bank is "loaned up" and can create no further deposits until given more cash reserves.

Appendix E

SOCIAL CREDIT SUBMISSIONS

TABLE OF CONTENTS

I. Introduction

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

2. The New Zealand Social Credit Association Incorporated was represented at our hearings by counsel who took the opportunity to cross-examine a number of the witnesses appearing before us. The presentation of evidence on behalf of the Association by Miss M. H. M. King and Mr R. G. Young, their cross-examination, and the opening and final addresses of counsel, Mr F. C. Jordan, occupied almost eleven days.

3. The case presented by the Association, which purports to be an educational body, had the approval and full support of the New Zealand Social Credit Political League. We were informed that *"the Social Credit Association and the League collaborated"* in preparing the case, but that it had been felt fitting that the Association should present the case to the Commission, because the Association was not a political body and this procedure would place the League on the same basis as the National and Labour Parties which were not presenting evidence to the Commission. However, Mr Jordan assured the Commission that the case presented embodied the considered views and policy of both the Association and the League, and that these two organisations represented, in his opinion, most of the social crediters in New Zealand.

4. At an early stage of the cross-examination of Miss King by Mr Walsh, representing the Federation of Labour, Mr Jordan objected strongly to questions being put to the witness on the policy of the Political League as submitted to the electors at the last general election. He argued that such questions were irrelevant to the case submitted to the Commission, and explained that the policy put forward by the League at the election had aroused *"the strongest resentment"* amongst some of its members and, as a result, certain matters had been reconsidered and *"rectified"* in the case presented to the Commission. He submitted that witnesses should be examined on the case before the Commission, not on statements made by the Political League in the past.

5. A similar attitude was at first taken by Mr Jordan to examination of his witnesses on material contained in certain Social Credit publications, in particular Mr Wilfrid B. Owen's book *How Social Credit Works* (Mr Owen being the leader of The Social Credit Political League). After some members of the Commission had stressed their difficulty in fully understanding the rather brief written submissions made by the Association and the meaning of many of the terms used in the submissions without referring to other Social Credit publications, and the desirability of clearing up apparent conflicts between the submissions and Social Credit literature, Mr Jordan withdrew his objection. Later, he reiterated it, but finally withdrew it again in respect of literature other than political literature.

6. In the course of discussion, Mr Jordan claimed that the Association's case was not based on Mr Owen's book and that this book had not been approved by the Political League before the election. It had, however, been approved subsequently in April 1955, and was now recommended for anyone wanting to understand the general principles of Social Credit, although it did not represent the considered opinion of the League on all matters dealt with therein. Much later in the proceedings, Mr Young indicated fifteen statements in Mr Owen's book with which he disagreed or which were being reconsidered by the League. (See Note 1 to this Appendix.) Owing to the absence of Mr Owen overseas, Mr Young was acting as leader of the League during the whole period of our public hearings, although he did not appear before us in that capacity.

7. Mr Jordan stressed, in a statement from his principals, that any opinion expressed by counsel or witnesses for the Association on any matter not arising directly out of the submissions of the Association was not admitted to be binding on the Association but must be regarded as the opinion of the person expressing it.

8. In fairness to the Association, the Commission deems it necessary and desirable to draw attention to the foregoing matters so that all interested persons will understand the relationship between the case presented to the Commission and other Social Credit literature which has been circulated throughout the Dominion in the past.

9. It is also desirable at this stage to remove any misconception which may be in the minds of many people that a full Social Credit policy is already being operated in Alberta or British Columbia. It was made quite clear to us by the representatives of the Social Credit Association that, while the legislation of the Government of those provinces was influenced by their Social Credit philosophy, they had been unable, by reason of being only a province of Canada, to implement the financial proposals of Social Credit. According to Mr Young, *"There is nowhere in the world where the financial technique of Social Credit is in operation"*. And Mr Jordan said in his final address, quoting Captain Rushworth, one of New Zealand's earlier Social Credit leaders: *"When we come to apply Social Credit, we will be sailing on an uncharted sea"*.

II. Summary of New Zealand Social Credit Association's Submission

10. We consider that the following is a reasonable summary of the submissions of the New Zealand Social Credit Association Incorporated:

(a) The Association's witnesses contended that the results accruing from the present monetary system were unsatisfactory. They said that public and private debt, taxation, and the cost of living were continually increasing; there was persistent insecurity as to personal livelihood, national prospects, and world trade; and the threat of war was ever present.

(b) They claimed that these defects were the result of the "gap" which was defined as *"the difference between the monetary value based on a fair return to the producers of goods and the providers of services on the one hand, and the amount of purchasing power in the hands of the people desiring to buy at that time, on the other . . . The gap exists today as it has existed in years immediately past . . . The existence of the gap means a shortage in the purchasing power of the community."*

(c) Evidence of this shortage of purchasing power, they said, was to be found in *"experience . . . the evidence of experience is overwhelming"*. There was evidence of the shortage in *"extension of the time-payment system"*; in *"the growth of public and local body debt"* (through which *"depression is kept at bay by the State or local bodies undertaking capital projects financed on debt money"*); in the struggle *"to find export markets"* as a result of *"an internal deficiency of purchasing power"*; and in *"the very occurrence of trade depression"*.

(d) In their view, a chief cause of the "gap" was that the banking system had a monopoly of the creation and destruction of money, so that all money came into existence as a result of interest-bearing loans to producers from the banks. They argued that, since no money was created to pay the interest charges on these loans, the community could meet them only by impoverishing one another or by going more deeply into debt to the banks. They saw a danger that, if these *"sectional institutions"* retained a monopoly of the creation of money, they would in due course *"buy up society, lock stock and barrel"*.

(e) They also claimed that not all the costs of business which must be charged into prices became purchasing power in the hands of the people. Moreover, it was their view that, as the techniques of production improved, the world was faced with the problem of distributing purchasing power to men who were constantly displaced by machines.

(f) As a result, they said, at certain times we had depressions; at others, as in New Zealand since 1936, the community bridged the gap by such means as the extension of the time-payment system and the growth of public and local body debt. They contended that some estimate of the shortage of purchasing power could be gleaned by noting the increase of £411 million in the national debt between 1936 and 1953.

(g) The shortage of purchasing power, they said, was always present in relation to total prices, was cumulative, and appeared to vary in relation to the prices of consumers' goods only in so far as it was masked by increased debt or export surpluses.

(h) The Social Credit Association's witnesses proposed that these alleged deficiencies should be remedied by delivering *"to the people of New Zealand goods and services"* (desired and available), *"including imports in exchange for exports"*, through the provision of *"adequate . . . purchasing power"* without *"public borrowing and oppressive time-payment debts"* and *"without inflation or deflation"*.

(i) This would be done with the help of a *"fact finding and advisory . . . National Credit Authority . . ."* which would make *"a national survey"* to determine:

(i) *"What our nation is capable of producing"*:

(ii) *"What we do produce and the cost of such production"*:

(iii) *"What measures our experts would recommend to increase production of* (desired) *goods and services"*:

(iv) *"The amount of goods and services from time to time available for which there is not sufficient money in the hands of people desiring to buy"*:

(v) *"To whom it is recommended the extra buying power be given and the means by which* (it) *would be given"*.

(j) The National Credit Authority would, accordingly, *"direct the amounts of national credits to be written from time to time to the credit of the nation"*. Such credits would cover:

(i) *"The amount of extra purchasing power to be issued from time to time as a credit to balance production and consumption"*:

(ii) *"Free credits to be written up from time to time to pay for public works of a non-commercial nature, and not to be financed out of taxation."*

Parliament would *"decide on broad lines the allocation of the free credits"*.

(k) If the trading banks and private lenders and institutions failed to provide adequate finance for production, it would be the job of the National Credit Authority to supply the deficiency.

(l) However, the Association's witnesses stressed that it was undesirable to rely solely on producer credit to provide the additional money required from time to time, because creation of money through producer credit at the same time created new debt, on which interest had to be paid and *"on its way to consumers such new money would create as many new costs as it subsequently cancelled"*. Present social security schemes, they said, were also unsatisfactory, because extra benefits were financed from high taxation and this involved the community in a continuous process of inflation. For this reason, they said, social crediters stressed the desirability of issuing consumer credits in the form of debt-free money.

(m) Also, they said, *"Governments representing the people should not borrow; they should be able to lend or give in the name of the people"*. In particular, *"borrowing for public works of a non-commercial nature is an injustice to the nation . . . The nation having made the sacrifice of a temporarily reduced standard of living* (to carry out the public works) *should not be plunged into debt on that account"*.

(n) They claimed that the argument that borrowing for public works was an antidote to inflation was a fallacy, because practically all the money subscribed to public loans would not in any case have been spent on consumer goods. Money created for public works would no more cause inflation, they felt, than money borrowed for public works.

(o) They explained that, though the Association did not wish to be irrevocably committed to any particular method of closing the "gap", the following methods were likely to be satisfactory and should be applied:

(i) Price subsidies in suitable cases to producers who would reduce their selling prices to agreed figures:

(ii) Reduction of taxation:

(iii) The increase of social security benefits without taxation:

(iv) Payment for public works of a non-commercial nature.

The finance in each case would be provided by an issue of debt-free money.

(p) They contended that the issue of debt-free money would contribute to the avoidance of inflation, because:

(i) There would be no debt or interest charges to pass on in prices;

(ii) The subsidy would be payable to retailers only on condition that they reduced their prices; and

(iii) A surer market would give an incentive to greater production.

If necessary, they would also support a switch of production from capital works to consumer goods.

(q) The Association's witnesses regarded farming and the industries allied to farming as the foundation of our national economy. To ensure proper development they felt that those engaged in these industries must be assured of a price in New Zealand money sufficient to meet costs plus a reasonable profit.

(r) They advocated that reserves of foreign exchange should not be built up beyond a reasonably prudent level.

(s) Finally, they argued that we should not sacrifice control of our economic life *"by joining Bretton Woods or any similar agreement"*.

III. Consideration of the Social Credit Analysis of the Existing System

11. The foregoing briefly summarises the submissions made by the Social Credit Association, and it is primarily on those submissions that this Appendix is based. The Commission also heard a number of other witnesses who classed themselves as Social Credit supporters. There were, however, many serious inconsistencies between the different versions of Social Credit and even between the submissions and the evidence of the representatives of the Social Credit Association. In the course of the following discussion of the Association's case, we shall attempt to indicate not only the apparent conflicts between the Association's submissions and evidence, but also some of the major differences between the views of the Association and of other witnesses on certain matters.

A. THE NEED FOR PERSPECTIVE IN CRITICISING THE PRESENT SYSTEM

12. It should be evident from our report that we do not feel that the present monetary system is perfect. Criticism of it is legitimate; but the Social Credit Association's criticism, which was similar to that of most other Socal Credit witnesses, is distorted. Many factors necessary to a balanced judgment are not taken into account.

Debt

13. For example, although it is true, as Miss King asserted, that New Zealand's national debt, in total and per head of population, is now much larger than it was in 1933, that is not the full story. Changes in the volume of production and in prices, which are reflected in changes in the gross national income, must be considered.

14. In 1932–33 the national debt was more than double that year's gross national income; but in 1954–55 it was only about four-fifths of that year's gross national income. Similarly, in 1932–33, interest on loans used up £59 in every £100 collected in taxation; in 1954–55 interest used up only £9 in every £100 of taxation.

15. Again, the vital difference between interest paid on loans held within New Zealand and interest paid on loans held outside New Zealand must be taken into account. Interest paid in New Zealand is merely a transfer of money from one pocket to another within the country, whereas interest paid outside New Zealand uses foreign exchange which could otherwise be used to buy imports. In March 1933 the Government's overseas debt was £174 million; in March 1955 it was only £100 million.

In 1932–33 overseas interest payments used up £18 in every £100 of overseas earnings; in 1954–55 interest payments used only £1 2s. in every £100.

16. These comparisons, which take into account changes in population and production, and the rise in prices, wages, and other incomes which has occurred during the period, and thereby relate debt to ability to pay, establish that the debt of the country today is relatively a very much lighter burden than it was twenty-two years ago.

17. The comparisons, it is true, are made between periods of economic adversity and prosperity, but this was the basis chosen by the Social Credit Association's witnesses in the presentation of their case.

18. It is a mistake to think that all the interest payments on the public debt go to a few wealthy people or firms. For instance, of the internal public debt of £631 million as at 31 March 1955, £182 million was held by the Post Office as the result of the investment of small savings by the public; £79 million represented reserve funds held for the benefit of the primary industries; £60 million was held by the Reserve Bank; and £23 million by the Government Superannuation Board and the Government Life Insurance Office. When other departmental investments are added to these, we find that £410 million of the internal public debt was held by Government or semi-governmental agencies. Of the debt held by the public, by far the greater proportion was held by insurance companies and trustee savings banks (which have always used Government securities as a major channel for investment of their customers' premiums or deposits) and by public companies. The trading banks (which according to many Social Credit witnesses held the State in bondage) held only £11 million of the public debt. And, of course, the largest bank is State owned. The money for payment of the annual interest charges is collected from the public in taxation; but it is clear from the above that a very large number of the public receive a share of the interest payments in the form of interest on small savings, bonus payments on life insurance, and so on.

19. Finally, we must not forget that the cost of many public assets has been met from the savings which the Government has been able to borrow from people in New Zealand and overseas. Some of the enterprises in which borrowed money is invested are earning for the State interest and profits, which amounted to £11·4 million in 1954–55, and which could reasonably be offset against the Government's interest payments of £20 million. Other assets, such as roads, bridges, and schools, do not directly earn income, but they certainly contribute to national production. Even the £188 million which was used for war purposes cannot be regarded as completely unproductive, in that it was of assistance in winning a struggle to retain our freedom to develop the type of society we want.

20. However, the most important point is that the great bulk of the increase in public and private debt in recent years represents a transfer of purchasing power from one section of the community to another. The increased prosperity of the country has led to a considerable increase in money savings. In addition it has led to a much greater desire by producers to borrow to expand their output, to much greater willingness of people generally to borrow in order to buy, build, or furnish a house or to purchase other goods they want, and to increased need for the central

and local governments to borrow to provide the extra public facilities, such as roads and streets, water supply, sewerage, power reticulation, etc., which an expanding economy requires.

21. For these reasons, private individuals, business men, farmers, companies, and public authorities have felt able and been willing to increase their total money indebtedness; but at the same time those who have lent to them directly or through a financial institution have increased correspondingly their interest-earning assets. In short, if internal public and private debt has increased, so has public and private money wealth; for what is owed by some members of the community is owned by others.

Taxation

22. A similar distortion marks the Social Credit Association's reference to taxation. Again, some factors necessary to a balanced judgment are not taken into account.

23. It is true, as the Association pointed out, that taxation per head of population increased from £53 12s. 4d. in 1942–43 to £99 8s. 3d. in 1952–53, but the proportion of the national income taken in taxation and the use made of the proceeds cannot be disregarded.

24. Unfortunately, the necessary figures are not available for the years chosen by the Social Credit Association, but the trend can plainly be seen by comparing the figures for 1938–39 and 1954–55.

25. The fact that the Government took a greater amount per head of population in taxation in 1954–55 than in 1938–39, and also a greater part of the gross national income (defined in the table on page 353) must be measured against the use made of the tax money.

26. The Government uses such funds for three broad purposes: to meet the running expenses of the country; to redistribute the national income through subsidies, social security payments, and so on; and to pay for capital works.

27. The table shows that in 1954–55 the Government, by comparison with 1938–39, used a smaller part of the national income on capital works and about the same part on running expenses, but it used a larger part for redistribution of the national income. Also, in proportion to the gross national income, it was left, as it was in the four previous years, with a surplus of current revenue over current expenditure considerably greater than the surplus in 1938–39. This surplus is used for capital works, or to pay off Government indebtedness, or to build up a fund against future needs. Broadly, we can say that the Government has used a much greater proportion of taxation for capital purposes than it did before the war, when its capital projects were financed almost entirely by borrowing.

28. The Government's spending on capital works and administrative, defence, and social services involves the use of labour, materials, and equipment. Redistribution through subsidies, interest on internal debt, and social security benefits merely involves a transfer of money from one section of the community to another; there is no real burden on the community as a whole apart from the comparatively small cost of administering the transfers.

29. The vital fact shown by the table below is that the Government is using no greater share of the nation's real resources, by spending on capital works and other goods and services, than it did sixteen years ago. It is, indeed, using a slightly smaller share and, as the witnesses for the Social Credit Association so often pointed out, it is real resources, not monetary values, that matter.

Central Government Taxation and Expenditure in New Zealand as a Percentage of Gross National Income

	1938–39 Per Cent	1954–55 Per Cent
1. Total taxation collected	16·4	25·3
2. Current expenditure on goods and services	10·0	9·9
3. Transfers (social security monetary benefits, subsidies, transfers to local authorities and interest on debt paid in New Zealand)	8·0	11·7
4. Surplus of current revenue over current expenditure on goods and services and transfers	0·6	5·8
5. Capital works expenditure	7·0	6·3

NOTE: Gross national income at market prices = the value of the goods and services produced in New Zealand during the year before deduction is made for depreciation of our capital assets.

—Compiled from Official Estimates of National Income and Expenditure 1955.

Cost of Living

30. The Social Credit Association's use of the rising cost of living as proof of the defects in the existing system must also be brought into proper perspective. Most people depend mainly upon salaries and wages for their incomes and it is therefore pertinent to examine the changes which have taken place in their economic position. The statistics show that the overall rise in the nominal weekly wage rate for adult male workers during the past twelve years has more than offset the fall in the purchasing power of the pound. Increases in nominal wages measured against increases in prices leave those wage earners who today are on the prescribed minimum rates one-fifth better off on the average by comparison with 1942 (see table given on page 354). It appears equitable that their position should have improved in view of the intervening increases in productivity.

31. But the shortage of labour and the consequent competition amongst employers have brought the rates of wages to a level probably about 10 per cent on the average in excess of minimum rates. To that extent the position of the average wage earner has been still further enhanced in relation to prices.

32. Of course, some sections of the community have improved their economic position even more than the wage earners, and on the other hand, now as always, there are some people whose incomes are insufficient to provide them with a desirable standard of living. In particular, those on fixed incomes have suffered a material disadvantage through loss of purchasing power. But the fact remains that the real income of the community as a whole has increased appreciably during the past twelve years. The goods available for use in New Zealand per head of population were 23 per cent greater in the year ended June 1954 than they were in 1939. This indicates that on the average the people of New Zealand are enjoying a considerably higher standard of living.

Index Numbers of Prices and Wages in New Zealand

(Base: 1926–30 = 1000)

	Retail Prices (All Groups)	Nominal Weekly Wage Rates (Adult Males)	Effective Wage Rates (Adult Males)
1942	1109	1222	1102
1954	1847	2459	1331

(Effective, or "real", wages are arrived at by dividing the index numbers of nominal wage rates by the corresponding all-groups index numbers of retail prices, and multiplying by the base value of 1000.)

Insecurity

33. As to the personal insecurity which the Social Credit Association considers to be a feature of contemporary New Zealand life, this is plainly absurd. New Zealanders, in general, have greater security than in the past. The State now provides reasonable protection against loss of income through unemployment and prolonged illness and against real hardship in old age; that is, protection against the vicissitudes of life which are the basic causes of personal insecurity. A further fact is that since 1946 there have never been more than 100 registered unemployed and never less than 11,000 registered vacancies. So far as the post-war years are concerned, these figures indicate a greater degree of security for the average employee than ever before in the country's history.

34. The Social Credit Association's proposition that there is insecurity in national prospects and international trade must be measured against Mr Colin Clark's computation in his submissions that *"the total market for internationally traded goods rose from £51 billion (adjusted to the present day purchasing power of money) in 1938, to £60 billion in 1950, and £74 billion in 1954"*. While some trading uncertainties must always exist, the buoyant receipts of recent years have enabled substantial reserve funds to be built up for the primary industries within New Zealand. The guaranteed price arrangements for dairy produce, and the floor price schemes for meat and wool, are designed to ensure a measure of stability (and therefore security) much greater than in the past for those engaged in these vital industries.

35. Finally, we have not heard a shred of evidence which would support the view that the *"ever-present menace"* of war can be attributed to some flaw in the monetary system.

Conclusion

36. To sum up, we find serious deficiencies in the Social Credit Association's analysis of the results accruing from the existing monetary system. Many of the contentions are completely unsupported by evidence; in the case of debt and taxation those statistics are selected which show the position in the worst possible light; little attention is paid to external factors which have played a major part in the rise of the cost of living in New Zealand since the war. The marked improvement which has taken place in the standard of living and the volume of goods and services available for use in New Zealand, both in total and per head of a much greater population, is ignored.

37. However, lack of balance in assessing the results accruing from the existing system does not of itself invalidate the Social Credit Association's diagnosis of the operation of the system and to that we must now turn.

B. THE IMPORTANCE OF THE "GAP"

38. The Social Credit proposal for an issue of debt-free money depends on proof of a gap between purchasing power and prices. The transcript of the proceedings furnishes abundant evidence in support of this statement. For example, in Miss King's examination the following passage occurs:

Question: I don't want to make any extensive use of Mr Owen's work (*How Social Credit Works*) but would you agree with this statement: "There is no single cause operating in the world today which is of such primary importance as the disparity between purchasing power and prices. The total argument for Social Credit as an effective reform rests on the proof of this disparity. If it fails, the case for Social Credit fails . . ."

Miss King: I would say that the case for the application of Social Credit, the use of it, would fail.

And in Mr Young's examination this passage appears:

Question: Suppose you had your survey, and it proved, in fact and statistically, that there was no gap, there would be no room for the application of any of these (Social Credit) measures, would there?

Mr Young: No, that is true . . . but we feel very confident that that would not be the result.

Question: . . . but, assuming there proved to be no gap, that would end the whole of your case, wouldn't it?

Mr Young: That is so.

Question: No gap, no Social Credit?

Mr Young: That is so.

And Mr Jordan declared:

There is no necessity for the creation of any money to balance available goods and services with purchasing power in the hands of the community if the gap does not exist.

C. WHAT IS THE "GAP"?

39. The Commission had great difficulty in ascertaining exactly what was meant by the term "the gap". In his submissions, Mr Young defined "the gap" as *"the difference between the monetary value based on a fair return to the producers of goods and the providers of services on the one hand, and the amount of purchasing power in the hands of people desiring to buy at that time, on the other"* . . . *"'The Gap' exists to-day"*, he said *"as it has existed in the years immediately past"*.

40. But Miss King distinguished two different "gaps" or, as she preferred to put it *"two degrees of the gap"*:

(a) There was never enough money in the hands of individuals as personal income to buy the whole of production; and

(b) Only under certain circumstances was income sufficient to buy the end or final production at prices remunerative to producers.

Miss King admitted, under examination, that there was no need for individuals to be able to buy the whole of production, i.e., to pay for all the capital and intermediate goods produced during the year as well as the consumer goods and services appearing on the retail market. The witness failed completely to show us the significance of the first degree of the gap.

41. Mr Young and Mr Jordan continued to speak as though there were only one gap – Miss King's second degree of the gap – to be filled. The concept is still not clear, e.g., the witnesses did not explain whether *"purchasing power"* means the amount of money in the hands of consumers at a given time, or the flow of income which they can expect over a future period; whether it includes or excludes their accumulated savings; whether it includes or excludes income earned in the production of capital goods; whether production refers to actual or potential production; and how we are to determine what people will be *"desiring to buy"* at a given time. Nevertheless it is our duty to examine the evidence put forward by various Social Credit witnesses to prove that there must be a chronic gap.

D. EVIDENCE PUT FORWARD TO SUPPORT THE THEORY OF A CHRONIC GAP

(a) Evidence from Experience

Growth of Debt

42. Miss King in her submissions claimed that the growth of public and local body debt between 1933 and 1953 *"measures the extent to which depression is kept at bay by the State or local bodies undertaking capital projects financed on debt money"*. Likewise, Mr Young, in his submissions, told us that *"some estimate of the shortage of purchasing power can be gleaned by noting the increase in the national debt during the years March 1936 to March 1953"*. The extension of the time-payment system was also cited as evidence of a gap. The Association's attitude here was shared by most other Social Credit witnesses.

43. Under examination, it was conceded by Miss King that the statistics showed no increase in the total indebtedness of local bodies between 1933 and 1953. The table on page 357 supplied by the Government Statistician showing some of the holdings of the internal debt of the Central Government indicates that the great bulk of the increase of £472 million which had taken place from 1933 to 1953 could be attributed to the investment of savings by the public, either directly or indirectly, through the Post Office and trustee savings banks, national savings, the reserve funds held for the benefit of the primary industries, and various public accounts.

HOLDINGS OF PUBLIC DEBT

The attached statement shows the increase between 1933 and 1953 in holdings of public debt by the Post Office Savings Bank, the Public Account, and some other large holders of public debt. The amount of £60,045,000 held by the Reserve Bank on 31 March 1953 includes £20,000,000 in respect of the 1948 exchange adjustment.

Government Securities Forming Part of the Public Debt Held by the Post Office Savings Bank, National Savings, Industry Accounts, and the Banking System, 1933–53

	1933 £(000)	1953 £(000)	Increase £(000)
Post Office Savings Bank and national savings	41,437	127,478	86,041
Dairy Industry Account	..	21,460	
Meat Industry Account	..	38,499	
Wool Commission	..	23,980	
			83,939
Public Account	2,767	54,374	51,607
Reserve Bank	..	60,045	60,045
Trading banks	5,800	11,700	5,900
Trustee savings banks: Government stock ..	2,453	24,418	21,965
National savings stock	..	7,588	7,588
National savings bonds	..	88	88
	52,457	369,630	317,173

44. The bulk of the remainder of the increase in the debt resulted from investments by insurance companies (placing the premiums paid by policy holders), by public companies, and by the Government Superannuation Board. That is to say, during the period in question, a section of the community found it unnecessary or undesirable to spend part of its income and transferred that part temporarily to the Government in return for an agreed annual interest payment. We cannot agree that this provides any evidence of a community shortage of purchasing power.

45. No evidence was produced to support the contention that the growth of hire-purchase indebtedness proved that there was a general shortage of purchasing power. No matter how high the level of the national income is, there will always be some people who want to have goods like a motor car or refrigerator now and pay later, rather than to save now and buy later. The fact that they buy on hire purchase does not prove that purchasing power is generally inadequate. As is the case with the increase in public debt, the increase in hire-purchase indebtedness represents, in the main, a transfer of purchasing power from one section of the community with surplus income to another which wishes to spend in excess of its income.

46. Towards the end of his cross-examination, Mr Young agreed that the total amount of money in the hands of the public could have been increased as a result of the growth of public and private indebtedness only to the extent that additional bank credit had been used to finance it. As far as the public debt is concerned, of the above increase of £317 million between 1933 and 1953 only £60 million was taken up by the Reserve Bank and £6 million by the trading banks. £20 million of the increased holdings of the Reserve Bank, representing compensation granted to the bank by the Government on account of the exchange adjustment of 1948, did not add to the volume of money in New Zealand. The total of the advances and investments of the Reserve Bank and the trading banks for all purposes increased by about £220 million between 1935 and 1955, i.e., by an average rate of £11 million per annum. This amount is very considerably less than the annual gap which most Social Credit witnesses seemed to have in mind. Over the same period, the Retail Prices Index (first quarter 1949 = 1000) rose from 632 to 1434. This would indicate that the supplementation of purchasing power which occurred through

bank credit during this period was more than adequate to counteract any tendency towards a shortage of purchasing power which might have developed in its absence due to the growth of production and population or rises in overseas prices.

47. The Association seemed to have second thoughts on this issue, for Mr Jordan, in a document addressed to the Commission dated 5 October 1955, commenting on a statement of the Reserve Bank, said, *"Our submissions do say that the increase of debt is evidence of a "Gap", but increases in debts, public and private, are neither a measure of the "Gap" nor conclusive proof of it"*.

The Struggle for Export Markets

48. The Social Credit Association claimed that an internal deficiency of purchasing power made it necessary to find export markets and achieve a favourable balance of trade. We agree that it is necessary for New Zealand to keep and enlarge her export markets for primary produce if the present standard of living is to be maintained or improved. But surely this need does not arise from any internal deficiency of purchasing power; it would be quite ridiculous to expect the local market to absorb all our production of wool, meat, and dairy produce. The need to keep and enlarge the export markets arises from the necessity to import materials and equipment for our growing manufacturing and service industries and to import other goods which cannot economically be made in New Zealand. It is also true that, overall, New Zealand has had a considerable surplus of receipts over payments in her external transactions since 1939. This has arisen not from any necessity to sustain internal purchasing power, but from the necessity to build up foreign exchange reserves from the dangerously low level which they had reached before the war and to maintain them at an adequate level in relation to the much higher world prices now ruling. In this connection Mr Young said that he would prefer to see our reserves a little higher than they were in the middle of 1955, although they would be adequate, he thought, if they were conserved.

The Occurrence of Trade Depressions

49. Miss King regarded the occurrence of trade depressions as evidence of a persistent shortage of purchasing power. Of course, we have had no depression since the early thirties. Asked whether she would regard a boom as evidence of a surplus of purchasing power, she replied that a boom was a condition of a surplus or an equality of purchasing power in relation to consumer goods, but not in relation to total production. As indicated earlier, she was unable to make clear to us the significance of this "Gap Major" to which she repeatedly referred.

Other Factors

50. Certain other factors were cited by the Association's witnesses and by the other social crediters as evidence of a gap. Mr Young mentioned the case of a firm in Otorohanga which had suffered a marked fall in turnover and said he felt its predicament was typical of many firms in the country at that time; but the statistics of retail trade did not support his contention for the country as a whole. Mr Dodds claimed that the

fact that it was necessary to employ salesmen and adopt various devices to stimulate sales was evidence of a shortage of purchasing power; but it is surely necessary in any economy to bring to the attention of consumers the products which are available for sale and the terms on which they may be bought, especially in a system of competition for custom among private firms, a system which Mr Dodds and most of the other social crediters claimed to support. Finally, several witnesses drew attention to the relatively poor circumstances in which certain old-age pensioners were living in New Zealand as evidence of the existence of a gap; this may be evidence of a maldistribution of income, but it does not prove that the general level of money income is too low.

Conclusion

51. **To sum up, the "evidence from experience" adduced in support of the contention that there is a chronic gap is completely unconvincing and unsubstantiated by any relevant statistics.**

(b) Theoretical Argument as to the Existence of a Gap

The A plus B Theorem

52. Surprisingly, only oblique reference was made in the Association's submissions to the A plus B theorem of Major Douglas, which has, in the past, been the main theoretical device used to justify the contention that there is a chronic gap. Miss King said, *"A careful consideration of the facts regarding the way in which production is financed, the creation and transfer of costs, the liquidation of costs . . . the way in which prices are built up will soon lead to a conclusion . . . that there is a chronic shortage of purchasing power in the hands of the people relative to the price of total production . . . It is easy to deny this by denying the facts, by declaring that A plus B is not greater than A, or that A is the same thing as B when it has just been defined as something different, but denial does not alter the facts".*

53. Apart from this, the A plus B theorem was not mentioned. Mr Jordan made it clear that the omission was deliberate. In discussing the relationship between the case submitted to the Commission and Mr Owen's book *How Social Credit Works,* he said, *" . . . the case makes some things very clear which I think were not made clear in the book. For example it makes it quite clear . . . that we would issue money as against an approved statement showing that there are goods available against which that money can be issued . . . You will find that that book discusses the A plus B theorem at length, something which is not actually mentioned in the case".* After the reference in Miss King's submission had been drawn to his attention, he was asked whether the Association was abandoning the theorem.

54. He replied, *"We are not abandoning it, but we are saying . . . it is of academic interest, because we tried to make it clear in the case that as far as the A plus B theorem is concerned, to use Major Douglas's own terms, it should be decided on the facts, not on the theory".* Under examination, Mr Young said that the Association did not regard the A plus B theorem as a basic principle. *"It is not worth arguing about"*, he said. *"Let us have the facts and prove conclusively whether it is right or*

wrong." From the foregoing, it would appear that this theorem, which in the past has been treated almost as the foundation of Social Credit, is now virtually discarded by the New Zealand Social Credit Association.

55. However, since Mr Adams (an advocate of Social Credit) regarded the theorem as "*the basis of the gap and . . . fundamental*" to the Social Credit case, and since it was used by one or two of those presenting written submissions, it is necessary to discuss it briefly in this report. First of all, we must state the theorem.

56. Major Douglas made a close examination of more than one hundred large businesses in the United Kingdom and found that, in every case, the total costs incurred were greater than the sums paid out in wages, salaries, and dividends. On the basis of his study he stated the following proposition; according to Mr W. B. Owen in *How Social Credit Works*, pages 48–49:

> A factory or other productive organisation has, besides its economic function as a producer of goods, a financial aspect. It may be regarded on the one hand as a device for the distribution of purchasing power through the media of wages, salaries, and dividends; and on the other hand as a manufactory of prices – financial values. From this stand-point its payments may be divided into two groups:
>
> GROUP A: All payments made to individuals (wages, salaries, and dividends).
>
> GROUP B: All payments made to other organisations (raw materials, bank charges, and other external costs).
>
> Now the rate of flow of purchasing power to individuals is represented by A, but since all payments go into prices, the rate of flow of prices cannot be less than A plus B. Since A will not purchase A plus B, a proportion of the product at least equivalent to B must be distributed by a form of purchasing power which is not comprised in the description grouped under A.

A simple diagram will help to illustrate this:

"A" PAYMENTS
Wages and salaries .. .. .. £90 } £100
Dividends .. .. .. £10 }

TOTAL COSTS — TOTAL PRICES £150 — Purchasing power £100 cannot buy goods priced at £150.

"B" PAYMENTS
Raw materials .. .. .. £30 } £50
Bank charges, etc. .. .. .. £20 }

57. Let us look briefly at the payments, other than salaries, wages, and dividends made by any business firm, i.e., Major Douglas's B payments, which he implies do not result in any distribution of purchasing power. These payments can be classified into five main categories:

(a) Payments for goods and services from other individuals or firms.
(b) Payment of rent.
(c) Payment of interest or bank charges.
(d) Depreciation allowances.
(e) Undistributed profits.

58. Mr Young conceded under examination that many of the purchases of goods and services which firms made would result in payments to individuals, e.g., purchases of raw materials from farmers, purchases

of standing trees by a sawmilling company, and so on. So would the payment of rent and interest in many cases. In short, many of the items classed as B payments by Major Douglas do represent a flow of purchasing power to individuals.

59. Other payments for goods and services and other rent and interest payments may be made to business organisations. But this does not mean that the sums paid are lost as purchasing power if they are paid to organizations within New Zealand. The B payments made by the retailer to the wholesaler are used by the wholesaler to make A payments of salaries, wages, and dividends and B payments to other individuals and firms. The B payments made by the wholesaler to the manufacturer in turn become the A and B payments of the manufacturer. As the B payments are traced back to the end of the process of production, it will be found that they all ultimately become A payments. That is, the sums paid by the buyers of finished goods or services become the A and B payments of the firms which supply them and their B payments eventually become the A payments of firms at an earlier stage of the process of production and sale. Thus, all the money paid in prices by buyers of finished goods and services ultimately becomes income in the hands of the workers or the owners of the resources which have been used in their production.

60. The issue is complicated to some extent in New Zealand by the fact that some payments are made to people and firms overseas and some receipts come from overseas. As long as external receipts and payments are in balance, the preceding argument is not affected. However, if receipts from overseas exceed payments overseas, a portion of the incomes received by exporters during the year has not been matched by bringing goods and services of equivalent value into the country. Therefore, incomes in New Zealand will be greater than the value of the finished goods and services retained in the country and the goods imported during the year. Conversely, if overseas payments exceed receipts from overseas incomes will be less than the value of finished goods and services retained in the country and imported during the period concerned. Of course, it is impossible for overseas payments to exceed receipts for any great length of time. There is therefore nothing inherent in the system to produce a permanent shortage of purchasing power.

The Time Factor in Production

61. As indicated above, Mr Young recognised some of the flaws in the A plus B theorem. But, in the course of discussion, he complained that a lot of the criticism of the A plus B theorem neglected the time factor in production.

62. To illustrate what is meant by this we cannot do better than quote "H.M.M." as does Mr Owen on page 55 of *How Social Credit Works*:

"All B items in cost were once A items – that is, they were somebody's income if we go back far enough. But money earned in the past is spent in the past and no longer exists. (It was created in production and cancelled in consumption.) Therefore, while current incomes avail to meet the current A items in prices, past incomes are not available to meet current B items.

63. The following example given in Mr Owen's book, page 54, was discussed with Mr Young:

Diagram of a Series Production

Year	Business	Bank Loan	Costs			Sales Prices	Payments		Profit
			Raw Material	Over-head	Wages		Bank	Interest	
		£	£	£	£	£	£	£	£
1951	Farmer	350	200	50	100	..	..	..	..
1952	Farmer	..	..	..	..	500	350	20	130
1952	Miller	1,000	500	200	300	..	..	..	..
1953	Miller	..	..	..	..	1,500	1,000	60	440
1953	Baker	2,500	1,500	400	600	..	..	..	..
1954	Baker	..	..	..	..	3,000	2,500	150	350
Totals	..	3,850	2,200	650	1,000	5,000	3,850	230	920

In examining this example of series production we see how overdrafts from the banks are repaid and such costs liquidated. The prices of the goods produced through the series were: wheat, £500; flour, £1,500; bread, £3,000; a total of £5,000. The money disbursed in the series was: raw materials, £2,200; overheads, £650; interest, £230; wages, £1,000; profits, £920. A total also of £5,000. If all these disbursements were saved and all made available at one particular moment of time the bread could have been all sold.

But they were not all saved and they were not all available. A period of three years has elapsed since the first disbursements were made and most of these were spent and no longer exist. This is true right through the series. The mill cannot grind with the water that has passed.

We note also that all costs incurred in one stage are allocated to the next stage and appear in prices even though the money representing these costs has been spent, so that when we come to the ultimate product – bread – all that is left to liquidate the total price of £3,000 is wages £600 (and part of this may be spent), profit £350, and proportion of bank interest, say, £50 – a total of £1,000.

64. Under examination, Mr Young agreed that this example failed to take account of the continuity of production and of the continuity of payments out in the course of production. He recognised, for example, that the farmer and the miller would still be operating in 1954 and making payments to individuals somewhat similar to those which they made in previous years. But the table takes no account of this fact when it shows a deficiency of purchasing power of £2,000 in that year.

65. Mr Young said that he placed no particular reliance on an example of this kind to prove that there was a gap. He wanted a proper national survey.

Interest, Depreciation, Undistributed Profits, and Other Savings

66. It can be seen that the Association's witnesses placed very little faith in the A plus B theorem as theoretical evidence of the existence of a gap. However, in common with several other witnesses, they selected certain B payments as explanations of the alleged shortage of purchasing power.

67. Great emphasis was placed on an alleged monopoly of the creation and destruction of money by the trading-bank system and the consequent necessity for interest to be paid on all the money which was created. Several witnesses mentioned depreciation charges and other business reserves as costs which no one received as a wage, salary, or dividend. Some selected repayments of past debts, especially of bank advances, as a cause of shortage. And, finally, most seemed to feel that the fact that

people saved part of their income meant that producers could not recover their full costs of production. Even if the savings were reinvested, they claimed that the problem remained because then two sets of costs were created against one set of incomes.

68. We discuss most of these arguments quite fully in the section of our main report dealing with Social Credit. Briefly, we find:

(a) **That the trading banks do not have a monopoly of the creation and destruction of money.**

(b) **That all money does not come into existence as an interest-bearing debt to the trading banks.** (A large proportion has been put into circulation because the Reserve Bank and trading banks have bought more foreign exchange than they have sold, or because the Reserve Bank has made advances to the Government or to marketing organisations.)

(c) **That it is fallacious to argue that payments of interest to the banks, creation of reserves by business firms, and savings by the people must cause a gap.** (The Social Credit witnesses here assume either:

(i) That the banks' interest receipts, business reserves, and savings are hoarded – whereas in fact, in normal circumstances, all these items will either be spent directly or made available for borrowing by other spenders – or

(ii) That each unit of money is cancelled as soon as it is spent and that fresh supplies of money are required to finance each new transaction – but in fact, money circulates; each unit of money helps to finance several transactions and becomes part of the incomes of several people during the year.)

69. The repayment of loans is broadly comparable with savings. We cannot see that any purchasing power is destroyed when one individual or firm repays a loan to another. The person who receives repayment is able to spend or relend the money. Purchasing power could be destroyed when a bank loan is repaid, but only if the person's overdraft limit were reduced correspondingly and the bank were unable or unwilling to lend the money to another borrower. On the other hand, of course, purchasing power could increase if bank credit expanded, as it has in New Zealand in recent years.

70. If people or firms hoarded their savings, or if financial institutions failed to find borrowers for the savings left with them, or if bank credit declined substantially, the national income would be likely to fall. But, if the accumulation of savings by one section of the community is matched by the spending of another section in excess of its income (either by borrowing money or using past savings) no deficiency of purchasing power to buy the goods and services which have been produced need arise. It should also be remembered that there may be occasions when spending from borrowing or past savings may exceed current voluntary savings, so that the national income will thereby increase.

Displacement of Men by Machines

71. It was claimed in Miss King's submission that one of the basic problems facing the world is that men are constantly displaced by machines, and that this must lead to a shortage of purchasing power.

The men cease to earn wages with which to buy the products of the machines, with the result that the machines themselves often have to be stopped.

72. In the first place, of course, this argument ignores the fact that the payments made by firms for machinery ultimately become income in the hands of the workers and proprietors who have assisted, directly or indirectly, in their construction. In other words, if the volume of machinery in use increases, so does the income of the increased number of people who help to make machinery. In many cases also, the invention of new machines creates a new demand for men to service them, to provide the raw materials or ancillary equipment required to construct and operate them, and so on.

73. Secondly, the argument assumes that those who are displaced in a particular firm or industry are (a) unable to find employment elsewhere, and (b) receive no income from the State or other sources if they are temporarily unemployed. We agree that, at times in the past, the problem of unemployment has been quite serious, although we are not convinced that technical change played more than a minor part in causing it. But today, almost everywhere, the attitude of public opinion to unemployment has been radically altered. Governments have accepted responsibility for maintaining full employment, and knowledge of the causes of and appropriate remedies for unemployment has increased. These changes have contributed to the much lower level of unemployment which has prevailed in most industrialised countries since the war than that which persisted in the years between the two world wars.

74. Under examination, the Association's witnesses admitted that the displacement of men by machines was not a problem in New Zealand at present; that, until now, the economic gains from the use of improved machinery had been taken out partly in the form of a higher material level of living, and partly in the form of greater leisure; that for many years full employment would be necessary in New Zealand; and that, if a stage should some day be reached where the full available labour force was not required to produce the goods and services desired by the community, the situation could be met by a reduction in working hours.

The Need to "Monetise the Real Credit" of the Nation

75. Some witnesses presenting written submissions seemed to feel that it was desirable that the volume of money should be expanded until it was equivalent to the value of the capital assets of the country. Traces of this attitude are evident in the submissions of Mr Young who claimed that *"the existence of men, machines, and materials to carry out a public work is an asset. Against this asset a credit should be written to the value of the productive power available. That credit should be equal to the payments out in respect of the public work"*. Mr Young was asked whether he had in mind here a calculation similar to that made by Major Douglas in his *"Draft Social Credit Scheme for Scotland"*. Major Douglas proposed that a money valuation should be placed on the whole of the capital assets of Scotland, including the commercial capitalised value of the population; then financial credit, i.e., money, up to that value could be created by an agency empowered to do so by the Scottish people. A similar proposal was put to the Commission by Mr John Hogan, to provide a *"mechanism through which the community's real credit"* would be *"monetised"*.

76. One difficulty which immediately becomes apparent in adopting a scheme of this kind is that the value of the community's capital assets is dependent on the level of prices ruling at the time the valuation is made. If the scheme were introduced in a period of rising prices, the increase in prices during the year concerned would raise the value of the nation's capital. This would justify an increase in the supply of money, which would intensify the inflationary pressure already existing, which would cause a further increase in prices. This process would be repeated until a crisis was reached. The converse would apply in a period of falling prices.

77. Mr Young, under cross-examination, said that he did not support such a scheme for New Zealand; the scheme for Scotland was, he said, only of academic interest and of no factual value. In his opinion, the writing of credits against any asset must be limited by the over-riding necessity to keep money in balance with production of consumer goods and services over given periods of time. Again, the national survey was necessary to determine whether or not such a balance was being achieved.

78. It became apparent during the cross-examination of Mr Hogan that the national accounts which he proposed would not determine whether an issue of additional money should be made. Even though the accounts showed that the "real credit" of the country was adequate to justify such an issue, the monetary authorities would still have to decide whether, in the prevailing circumstances, their "net profit" should be used for this purpose or merely transferred to reserve. Mr Hogan recognised that *"if you decide to monetise the whole and not increase reserves, then the result of that might be detrimental to the country's development . . . The allocation of that net profit . . . is something which will have to be learned by experience and which will change according to the extent to which the country is engaged in capital development, the extent to which the community is prepared to save from its current income"*.

79. In other words, after undertaking a complicated book-keeping exercise to determine the "net profit" of the nation, the monetary authorities are left with the same problem as they face today, i.e., to determine whether, in the prevailing circumstances, there is too much or too little money in circulation. The "National Credit Account" is of no practical value, in our view, to help them solve that problem.

Conclusion

80. We conclude that the theoretical analyses put to us by various Social Credit witnesses to support the contention that there is a chronic gap are fallacious.

E. ESTIMATES OF THE SIZE OF THE "GAP"

81. During his cross-examination, Mr Young answered questions on certain estimates of the size of the gap which had been made in three Social Credit publications in New Zealand during the past two years.

82. At an early stage of his cross-examination Mr Young said that an estimate of the 1951–52 gap of £193·5 million which had appeared in an election pamphlet of the Social Credit Political League in 1954 *"was not drawn out of the air"*. A *"survey had been made very well by qualified accountants, as far as they could get at the figures"*. He *"would*

not have supported anything that was unsound" but he was "*satisfied from the facts that were produced*" that he "*was on perfectly safe ground*" here. But later he admitted that the statistical work which had been done could not be regarded as competent and that all the estimates which had been made contained serious errors. We examine these estimates more fully in the attached note. (See Note 2 to this Appendix.) After this discussion, Mr Young said that anyone who contended that there was a net gap of £190 million in 1951–52 was a dreamer. He was aware that the table used in the League's pamphlet could be interpreted in that way, but drew attention to the fact that the League had promised to issue only £80 to £90 million of new money. He stressed that no one was in a position to say what the gap was until a national survey had been made.

83. In his final address, Mr Jordan claimed that statements giving estimates of the gap had, in all cases, been the estimates of individual social crediters. "*I should say truly that those statements have never been received as correct by the general body of social crediters, nor by the many who have always . . . objected to those statements from time to time, on the ground that the compilers haven't the necessary information, and on the further ground that the state of full employment and the state of high prices under which our economy has existed during the past few years have indicated that there could not be anything like the amount of gap that has been estimated.*" **It is obvious, therefore, that no reliance can be placed on the estimates of the gap which were considered before us.**

F. DOES THE "GAP" EXIST?

84. As the hearings proceeded, the faith of the Social Credit witnesses in the existence of a gap seemed to diminish.

85. There is a significant contrast between the original prepared submissions of the Social Credit Association and Mr Jordan's final submission as its counsel.

86. In her written submissions, Miss King argued – There is "*. . . a chronic shortage of purchasing power to buy the goods and services produced and liquidate the prices which industry is entitled to charge*". She also remarked, "*This shortage of purchasing power is either a fact or not a fact. For the establishment of a fact we seek evidence and for evidence we go to experience. The evidence of experience is overwhelming*".

87. Yet, in his final address Mr Jordan declared, "*It has been made abundantly clear, both from our submissions and from the evidence that has been given, that we do not postulate a chronic shortage of purchasing power*". And again, in a document sent to the Commission on 5 October he said, "*It is not contended that there is a permanent deficiency in purchasing power, but it is claimed that any serious shortage in purchasing power should be remedied*".

88. Likewise, in his prepared submissions, Mr Young stated, "*The gap exists today, as it has existed in the years immediately past*".

89. Yet, in Mr Young's examination, this passage occurs:

Question: Would you not say the evidence is strongly against any shortage of purchasing power; (that it) strongly suggests an excess of purchasing power in New Zealand?

Mr Young: Up to the last nine or ten months I would say it is correct.

G. CONCLUSION AS TO THE "GAP"

90. The Social Credit witnesses completely failed to convince us that the present system is characterised by a chronic gap. We are confident that, in general, sufficient income is generated in any period to enable the people of the country to buy the finished output retained in the country and the goods and services imported during that period and to cover the costs involved in their production and sale.

91. This does not mean that the level of income or spending is always adequate to enable the best use to be made of the country's resources; nor does it mean that the levels of spending, output, and income never change. As we know, the level of spending, and therefore the incomes of people, may change for a wide variety of reasons. People overseas may decide to spend more or less on our products; people in New Zealand may decide to save a higher or lower proportion of their incomes than before; financial institutions may make credit more or less freely available; the Government may increase or reduce its spending. Thus, while we are confident that, under the present system, there is no inherent shortage of purchasing power, we are fully aware that there is no reason to believe that spending and incomes will automatically be maintained at that level which is in the best interest of the economy as a whole.

92. It seems evident to us that, since the war, spending has generally been excessive in New Zealand in relation to the goods and services available. Certainly some people have had insufficient to buy the goods and services which many regard as providing the basis for a reasonable standard of living; some have suffered considerably from the continually depreciating value of their savings or their relatively fixed incomes. But, for the community as a whole, all the evidence points to an excess of purchasing power. There has been no undue accumulation of stocks; unemployment has been negligible; there has been a very large number of registered employment vacancies; and prices have risen constantly. These things would not have happened if there had been insufficient purchasing power in the hands of the people.

IV. The Social Credit National Survey

93. The only positive proposal maintained throughout our hearings by the Social Credit Association was that a National Credit Authority should be set up to carry out a national survey. The survey would be designed to achieve the following objectives:

(a) To ascertain *"what we do produce and the cost of such production"*.

(b) To discover *"what our nation is capable of producing"* or more specifically *"what it is practically possible to produce in the immediate future, having regard to our manpower and the machines which we have available and can produce within that time"*.

(c) To enable those undertaking the survey and other experts to suggest measures to increase the production of goods and services desired by our people.

(d) To estimate the amount of labour expected to be used on capital and consumable goods.

(e) To establish the relationship between *"the amount of goods and services which are available to the community"* and *"the amount of purchasing power which is in the hands of the people who desire to buy those goods and services"*.

(f) To enable the Authority to recommend to whom extra purchasing power should be issued.

(g) To provide an objective for industry to strive for.

(h) To provide information for the people so they may take an intelligent interest in economic policy.

94. The Association's witnesses envisaged that the survey would be made every year, but that every quarter there would be an assessment of consumer goods available and of purchasing power in the hands of the people. It was not expected that the survey would require a department of officials; much voluntary help would be obtained from various trade organisations. The survey would grow from modest beginnings. At first, attention would be concentrated on deciding what industries should be helped to increase production, and on obtaining an accurate estimate of the balance between goods and purchasing power.

95. The Social Credit witnesses did not seem to appreciate fully that a considerable amount of statistical information is already available on various aspects of production, although many figures appear some considerable time after the period to which they relate. The Association was informed by the Government Statistician that it would not be an unduly onerous task to bring all the available data together, but that a complete census of services would be required to ensure adequate coverage.

96. The questions as to what our nation is capable of producing and what measures the experts would recommend to increase production are linked and can be conveniently discussed together. New Zealand is capable of producing a large number of different combinations of goods and services; experts could probably suggest effective means to increase production in almost every industry in New Zealand, provided capital, materials, and manpower were available. Unfortunately, however, our capacity to produce is limited in relation to what we would like to have, and when our labour and resources are fully employed, expansion of the production of one thing can be achieved only at the expense of a reduced production of another. Our major problem is to allocate the limited volume of labour, capital, and materials available among our many industries in such a way that the various goods and services which we can produce are turned out more or less in the quantities which consumers want to buy with the money they have available for spending. Today we rely mainly on a system of competition among producers to satisfy the wants of consumers, subject to overall control by the State in the public interest. The Social Credit Association envisage a comprehensive national survey and recommendations by experts as to how resources are to be allocated. If this is to be effective, it appears to us that rigid control of the economy in detail would be necessary to ensure that those recommendations of the experts accepted by the Government were carried out. This is wholly inconsistent with the expressed objective of Social Credit witnesses of encouraging a system of free enterprise.

97. So far as the assessment of goods and services available and purchasing power is concerned, the Government Statistician drew the attention of the Social Credit Association during our hearings to the

great difficulties involved in the statistical measurement of the availability of services. He also said that it was difficult to value goods at various points of the distributive process and to separate capital from consumer goods in assessing the value or volume of goods available for use. We have already commented in our discussion of the gap on our difficulty in deciding what is meant by "purchasing power in the hands of people desiring to buy". **In the absence of a clearer concept, we do not recommend a survey of the type suggested by the Association.**

98. However, we do see merit in many of the basic ideas underlying this proposal for a national survey. We agree that it is important that the Government should actively foster research into the natural resources available in New Zealand and assist our various industries to increase their efficiency. We share the view of the Social Credit Association that men and resources should not be idle because people have insufficient incomes to buy the goods and services which are capable of being produced by those men and resources. Now that the Government has assumed responsibility for ensuring as far as possible that this shall not happen, and to enable it to avoid the alternative danger of inflation, it is essential that it should be fully aware of current developments in the economy and be in a position to make reasoned estimates of probable future trends, so that it may make timely and appropriate adjustments in its monetary and fiscal policies. To this end, we set out in our report proposals designed to foster more research into the operation of the New Zealand economy and to secure the extension and more rapid production of certain statistical series. We feel that the adoption of these proposals would go a long way towards achieving the objectives which the Social Credit Association had in mind in proposing its national survey.

V. The National Credit Authority

99. Mr Young in his submissions proposed that a National Credit Authority should be set up to carry out the national survey and to *"direct the amounts of national credits to be written from time to time to the credit of the nation"*. At first Mr Jordan said that Parliament would surrender to this Authority the power of determining the amount of free credit. In our view, it would be most undesirable for any Government to set up a body which was superior to itself in controlling the country's money supply.

100. By the time our sittings concluded, the Association appeared to have changed its views on this point, for Mr Jordan said in his final address: *"It is essential that this authority shall be answerable to the people and to Parliament"*.

101. We consider elsewhere in our report whether it would be desirable to set up a fact-finding and advisory authority of the type proposed by the Association.

VI. Reform of the Monetary System

102. To carry out Social Credit policy it would be necessary, according to the Social Credit Association's witnesses, that *"the beneficial ownership of financial credit"* should be *"vested in the community"*. In the opinion of the Association, as advanced by Miss King, *"the banking system in its exercise of the vital function of the creation and cancellation*

of financial credit" should be *"in the nature of a trustee for the people and its claim to own the credit it deals in"* is *"usurpation of the most important and powerful social asset the community possesses"*.

103. Mr Jordan, on the other hand, committed himself to this statement in his final address: *"We do not allege . . . that the banks have usurped the State's prerogative to create money. We allege that they did and had until the passing of the Reserve Bank Act . . . but we can see that nominally at least now, the control of money is in the hands of the Government"*.

104. As explained elsewhere in this report, it is clear that the Government through the Reserve Bank can, if it wishes, control the operations of the trading banks. Further, it can, if it wishes, create and destroy money through the Reserve Bank. What then becomes of the Social Credit Association's contention that the *"beneficial ownership of financial credit"* should be *"vested in the community"*?

105. Under a Social Credit regime, as envisaged by Miss King and Mr Young, the banks would be *"tied to certain limits for the creation and lending of money"* (as indeed they are today), but, in general, they would function much as they do now. Advances would not be reduced and interest would still be charged on them.

106. The issue, therefore, seems to be finally resolved in Miss King's answer to this question: " . . . *would the only difference* (in the monetary system) *between what you want and what now exists be the issue of debt-free money?"* Miss King: *"I think, yes, it would come down to that"*.

VII. The Issue of Debt-free Money

107. It is difficult to discuss the proposals for monetary reform put forward to the Commission by the Social Credit Association because of their provisional nature. In the first place, apart from the rather nebulous proposal to restore to the people the ownership of financial credit (discussed above), it was clear that the Association envisaged no change in the existing monetary system unless the national survey disclosed a gap. The Association's witnesses stressed that they did not share the view that money could be issued purely on the basis of Social Credit theory as distinct from the economic facts, for it was recognised that if there were no surplus supply of goods and services and no prospect of an immediate increase, a large sum of extra money would cause serious inflation. They were not in a position to say what amount of debt-free money should be issued at the present time. That would depend on the size of the gap which could be determined only as the result of a national survey. As we have seen, however, their faith in the existence of a gap seemed to diminish as our hearings proceeded.

108. In the second place, the witnesses for the Association did not wish to be irrevocably committed to any particular method of closing any gap which might exist. However, it was suggested in the submissions that, if a gap existed, "debt-free" money might be issued for the purpose of:

(a) Paying price subsidies to retailers who would reduce their selling prices to agreed figures.
(b) Reducing taxation.
(c) Paying increased social security benefits without taxation.
(d) Paying for public works of a non-commercial nature.

109. Miss King also considered that, if the situation permitted, it would be appropriate to issue debt-free money to repay Government loans as they fell due and to subsidise the cost of housing. Both she and Mr Young thought that the National Credit Authority might issue debt free to the Government the money necessary to make loans to those building a house, although those getting the housing loans would be expected to pay interest at ruling rates and repay the loan, since it would be unwise to disturb existing methods unduly. Moreover, it was envisaged that debt-free money might be used to sustain the incomes of farmers should export receipts fall and for the purpose of training men displaced by changes in consumers' tastes.

110. On financing the commercial works of Government, the attitude of the Social Credit witnesses was rather confusing. Miss King thought that such works should be financed by a *"creation of national credit"* issued to them *"without the incurring of an addition to the national debt"*. But she foresaw that, though the community, via the Government, would not be placed in debt as a result of Government works, the particular department or agency undertaking the work would owe the money to the community. Under examination, it appeared that she envisaged the sale of shares in the undertaking, but this was not at all clear. Mr Young said he did not regard borrowing for commercial works as an injustice, because he felt that, where the State was in competition with private enterprise, it should compete on equal terms. He agreed with Miss King that money for commercial works might be created by the Reserve Bank, but felt that it should be repayable with interest. However, he regarded the Railways and the Post and Telegraph Department as public services which should receive finance debt free; he would also make it available for hospitals and for the capital works of local bodies. Nevertheless, he stressed throughout that the issue of any debt-free money was dependent on the existence of a gap as revealed by the national survey.

111. Other witnesses were so convinced of the existence of a chronic gap of very large dimensions that they made no mention of the necessity for a survey, and some went so far as to say that all Government expenditure should henceforth be financed by debt-free money instead of by taxation and borrowing. Indeed, one witness argued that *"too much purchasing power is mathematically impossible"* and that *"so long as there is debt to liquidate, there is room and need for the creation of debt-free credit to cancel it"*.

112. As we point out in our report, there is no technical reason why the Government should not require the Reserve Bank to grant it debt-free advances. The question is whether it is desirable in the national interest that this should be done.

VIII. Finance for Production

113. It is evident that the Association's witnesses envisaged little, if any, change from the existing system in the provision of finance for private production. This conflicts with much Social Credit literature, which commonly condemns the charging of interest, particularly on bank loans; opposes "debt finance" in all its forms; and argues that the credits required to finance production should be supplied not from savings which have no economic virtue, but by new credits. Some writers go so far as to

envisage the complete abolition of debt and interest, e.g., Mr A. E. Willyams, a member of the Dominion Executive of the Association, in his book *Social Credit Is For Me* says, *"If Social Credit is not intended to get people out of debt and keep them out, it is not worth consideration. No debt, no interest – usury will cease to exist"*. Similar views were expressed in several submissions to the Commission.

114. Mr Young said he and his Association regarded such views as *"rather starry-eyed"*. They agreed with all those who maintained that this country had been built up by hard work and that it would only be maintained and extended in the future by hard work. There was no intention, he claimed, in responsible Social Credit quarters of issuing money against the air. Under a Social Credit Government, debt would not be abolished between individuals, or between the State and the individual although, if possible, they would like to see the Government obtain its own financial requirements without incurring indebtedness to do so.

115. Mr Young agreed that the possibility of borrowing fairly large sums of money through the issue of shares, debentures, and mortgages enabled private individuals, singly or in combination, to control expensive establishments like a factory, a shop, a bank, a farm, or a home without completely owning it. If that type of debt were abolished, either the accumulations of capital necessary for modern production could not be built up or all finance would have to be provided by the State. This latter course would be inconsistent with the Social Credit Association's support of private ownership and private enterprise.

116. Most Social Credit witnesses (including Miss King) obviously had mixed feelings about the economic virtue of savings; one, indeed, said *"Saving is worse than a virtue; it is a vice"*. On the other hand, Mr Dodds, on behalf of the Board of Promoters of New Zealand Incorporated (a Social Credit organisation), regarded private savings as *"the foundation upon which a Social Credit economy must rest, because Social Credit is a policy which can operate only within a system of private enterprise; and private enterprise is that system in which savings are made by people foregoing the purchase of consumer goods and using the money so saved to acquire shares in the capital of companies, or to set themselves up in business on their own account"*.

117. Mr Young declared that there was no intention of interfering with savings. He opposed the suggestion made on page 68 of Mr Owen's book and by some other Social Credit witnesses that all future production should be financed from new bank credit rather than from savings, because he felt that it would be unreasonable to prevent a man from using his savings in production if he so desired. The Association, according to Mr Young towards the end of his evidence, did not accept the view that there was no economic value in savings. He acknowledged that, under the present system, if people decided to save no longer, but to spend all their incomes on consumer goods, there would be a fairly wild inflation of prices. He was satisfied that the savings of the people would be protected under a Social Credit regime – if anything, he thought, they would appreciate in value. (We discuss this contention later.)

118. As far as interest was concerned, Miss King said that many social crediters regarded it as iniquitous. And the evidence of most of the social crediters who appeared before us confirmed this. Again, Mr Dodds was

an exception. He regarded debt as *"the normal process of making use of savings"* and could see *"no fault in interest – it provides somebody with income"*.

119. Miss King considered that most social crediters realised that interest could not immediately be wiped out without considerable disturbance, and were therefore prepared to tolerate it in the meantime until conditions evolved to the point at which it would naturally disappear. It was pointed out to her that, if the Government no longer borrowed from the public for capital projects but financed them from debt-free money, the people and the financial institutions with which they deposited their savings would be denied what was now a major source of investment; as a result, it was certain that all rates of interest would be reduced. Miss King thought it would be possible for existing rates of interest to be fixed by decree; but when she was shown some of the difficulties involved in fixing a minimum interest rate, she admitted that she had not thought through that aspect of the problem.

120. Mr Young was also disturbed by some of the implications of a substantial reduction, or the abolition, of interest. He recognised that the use of debt-free money by the Government would have a depressing effect on interest rates; but he thought that if the public wanted a means of investing some of their money which could not be placed in private industry, a channel could be provided in the Post Office at $2\frac{1}{2}$ to 3 per cent. When he was reminded that the Post Office Savings Bank would no longer be able to invest in Government securities, and was asked where the bank would obtain the money to pay interest to depositors, he suggested that it be met out of Government revenue, perhaps from debt-free money if the gap were sufficient to justify such a payment.

121. This, of course, is merely one of the problems which would arise if interest were abolished or drastically reduced. All financial institutions would find it necessary at least to increase their charges and premiums steeply, and possibly to suspend their operations; the main sufferers would be those who had left deposits with or paid premiums to them. The incentive to lend to others would be drastically reduced and one of the foundations of a society based on private ownership would thus be severely weakened. The prices of capital goods from which a profit could be made or a rent earned would be inflated – unless, of course, the State stepped in to allocate the existing capital goods and control the production of new ones. It seems rather anomalous that objection should be taken by many social crediters to a man's lending his savings at interest but none to his buying property with them and renting it, or to his buying a business, hiring a manager, and living on the profits.

122. That Mr Young was aware of some of these problems became obvious later in his evidence. He envisaged a gradual reduction of interest rates – and he hoped that they would be reduced over the years to *"the cost of providing a service"*. But he did not want to abolish interest, because he could see no reason why people who saved, and wished to invest, should not be able to do so. As he said in a later submission: *"If the owner or part owner of commercial, agricultural, or other capital should decide to sell his capital, this means in effect that he exchanges his capital in the form of property for money. It is therefore envisaged as just, that moneys for investments being the proceeds, as it were, of assets, should carry some interest as profit, the equivalent*

of rent for the assets, if the assets had not been sold". As with private debt and savings, he did not foresee much change in interest rates under a Social Credit regime from the present system, at least in the near future.

123. Finally, it might have been expected that Social Credit policy would have envisaged the disappearance of the trading banks, to whom much odium is attached in Social Credit literature. But, as indicated earlier, the witnesses for the Association envisaged that, in general, the trading banks would function much as they do now. They would be *"tied to certain limits for the creation and lending of money"*, but as far as the provision of finance for production was concerned, it was only when the trading banks and private persons and institutions failed to provide *"adequate finance"*, that the National Credit Authority would be expected to step in to supply the deficiency, and then probably *"through the Bank of New Zealand"*. Again, therefore, the Social Credit Association wishes to make no radical departure from the existing system. Whether, in fact, the Social Credit proposals could be adopted without radical changes in the existing system, we shall consider a little later.

124. The above discussion should indicate why we do not recommend any attempt to abolish debt or interest, as was suggested by many witnesses. In particular, we feel that such an attempt would ultimately result in the disappearance of private ownership – a result which very few of the social crediters seemed to want. (See also Appendix C, Section III, on these questions.)

IX. Should the Government Tax and Borrow?

125. Several witnesses declared that it was sheer folly for the Government to tax or borrow as much as it did today. According to one witness, *"none of us live on a standard of living that we would enjoy if we were given adequate purchasing power"*. *"Debt-free money for all Government expenditure"* (which in 1954–55 amounted to about £260 million) would *"add to the incomes of the consuming public"* but *"not add to costs as debt money does"*. It would *"enable the producers to recover the costs of production and so run at a profit instead of at a loss"*.

126. As we have indicated above, the witnesses for the Social Credit Association were much more cautious than this, but their evidence revealed vestiges of a similar attitude to taxation and borrowing. Miss King envisaged the abolition of debt and taxation as an ultimate objective, but felt that *"a certain amount of taxation"* was necessary at present. In her submissions she said that governments should not borrow and she quoted with approval a statement made by Dr Schacht in the 1930's that *"money doesn't have to be 'got' nowadays. We simply issue the necessary credit and put men and materials to work"*. Mr Young considered that it had been foolish policy to maintain taxation at a high level and to borrow from the public in New Zealand and overseas in recent years. He claimed that borrowing for public works of a non-commercial nature was an injustice to the nation, and regarded as fallacious the argument that borrowing for public works was an antidote to inflation.

127. Of course, the above views rest largely on a belief that there is a substantial "gap" which it would be desirable to fill by an issue of debt-free money. As we have said previously, all the evidence is against such

a belief. In the absence of a national survey, the Association's witnesses were quite justifiably unwilling to commit themselves on the question of precisely how much debt-free money might be issued, but we were surprised at the amounts which, in the early stages of our proceedings, they seemed to consider it possible to issue in current circumstances without the risk of disastrous economic results. Miss King seemed unconcerned by a suggestion that, through tax reductions, increased benefits, and payment for Government works, £156 million of debt-free money might be issued in the first year of office of a Social Credit Government. Mr Young first spoke with approval of an estimate of a gap of over £190 million for 1951–52, but later denied that he ever contemplated a net gap of that extent and drew attention to the fact that the 1954 proposals of the League involved an issue of only between £80 million and £90 million of new money.

128. Any Government which issued £80 to £90 million of new money in order, say, to enable taxation to be reduced or social security benefits to be increased, would still cause very serious inflationary effects in an economy where the labour force was fully or more than fully employed, as it has been in New Zealand in recent years. The effects would become disastrous if a similar issue were repeated in succeeding years, as it would be if the tax reductions or increased benefits which had been given were not withdrawn.

129. Those who make goods or perform services for the Government naturally want payment in money. The Government can obtain this money in four main ways:

(a) By taxation.
(b) By borrowing from the public.
(c) By borrowing from the trading banks.
(d) By creating the money itself, either by printing notes or borrowing from the Reserve Bank.

Obviously, as a short-sighted expedient, the fourth method is the most attractive because services can be given and benefits paid without relieving any elector of his money or making it more difficult for him to borrow from private institutions. But, if we take a long-term view, it becomes apparent that, when resources are fully employed, the creation of money is merely a form of concealed taxation, imposed in a most inequitable manner.

130. Assume for example, that the Government wishes to expand its works programme and requires labour and resources worth £20 million at present prices to carry out the extra work. Since the labour force is already fully employed, workers must be drawn away from the private sector of the economy if the public works are to proceed. If the Government raises the money to pay for the labour and resources by taxation or by borrowing from the public, the community is affected, partly in the form of lower incomes after tax, partly in the form of higher prices if traders manage to pass on some of their tax, and partly in the form of a reduction in the amount of capital available to the private sector. Suppose, however, that the Government pays for the labour and resources by issuing £20 million of debt-free money. Again they will be drawn away from the production of goods or services for the private sector; but, in this case, there will be no reduction of spending power in the hands of private individuals. People will be able to spend as much as before, but

there will be less consumers' goods and services available for them to buy. In other words, the spending power of the community as a whole has been increased by the issue of debt-free money, but the total of capital and consumer goods available cannot be increased. In this situation, extra competition for the available goods and services must drive up their prices, unless the Government can induce the people to save much more than before. But, especially in peacetime, there is a limit to the extent to which people are willing to build up their savings balances. Without such saving, the Government will obtain its requirements at the cost of a substantial rise in the prices of consumer goods and services. And this initial decline in the value of money would probably result in claims for higher incomes which, if granted, would still further increase costs and prices. The process of inflation would have begun.

131. To summarise, if production is already at a maximum, the Government can acquire more resources only at the cost of a reduction in the goods and services available to the private sector. This being so, the private sector must accept a cut in its purchasing power over goods and services. To us, it would seem more just and equitable that the cut should take place through a system of taxation based on the people's ability to pay, plus a certain amount of voluntary lending to the Government, than through a rise in prices which must hurt most those who are least able to increase their incomes, and who have built up savings, in many instances at some sacrifice.

132. Thus, in the conditions which have ruled in New Zealand since the war, we do not agree with Mr Young's view that *"borrowing for non-commercial public works is an injustice"* and that *"the argument that borrowing for public works is an antidote to inflation is fallacious"*. His view might have a certain amount of merit if, as he seemed to think at one stage, the great bulk of the money subscribed to Government loans came directly or indirectly from trading-bank credit. But the figures quoted earlier, showing the holdings of the public debt, indicate that this is not so. Mr Young himself admitted later in his evidence that the tax and loan money used for public works came, in the main, from the existing supply of money. However, he insisted that *"money created for public works would no more cause inflation than money borrowed for public works"*. Yet he had agreed that, if the money were created, additional money would be issued and the money which would otherwise have been borrowed for public works would remain in the hands of individuals or firms to spend elsewhere in the economy. Total demand for goods and services must surely be higher in this case than when existing money is lent to the Government.

133. Mr Young also insisted that *"borrowing for public works of a non-commercial nature is an injustice to the nation"*. But he later said that it was *"only possible to obtain justice so far as practicable"*; that inflation would be a greater injustice to the nation than borrowing; and that, as a last resort, he would borrow rather than cause inflation. He stressed that the issue of debt-free money, even for non-commercial works, was dependent on the existence of an ascertained gap; he would not issue debt-free money for public works if sufficient money was available for investment from savings. Mr Jordan also said that, if the effect of issuing any money for public works would be to create a state of inflation, a Social Credit Government would have to rely on taxation.

134. Nobody likes Government borrowing and taxation for their own sake; but one of the primary duties of Government is to use these measures so as to ensure that the total spending of the community is kept in balance with the resources available at current prices. The above statements indicate that, at least towards the end of our hearings, the Social Credit Association's witnesses had begun to appreciate that taxation and borrowing are not unmitigated social evils, as we were told by so many other social crediters, but that they have a positive role to play in preventing inflation.

X. Social Credit and Inflation

135. The preceding section indicates that the witnesses for the Social Credit Association recognised that it was possible for an excessive issue of money or credit, and excessive spending, to cause inflation. They also said that they appreciated the evil effects of inflation; Mr Jordan said that the Association realised that an *"indiscriminate issue of money"* would *"ruin any system"* and *"never bring the efficiency and the justice that we seek to introduce into the economy of this country"*.

136. But a high level of spending played almost no part in the diagnosis by Social Credit witnesses of the causes of the rise in prices which we have experienced in New Zealand since the war. Mr Young attributed this mainly to increased import prices, increased taxation (which he implied was a reflection of increased indebtedness), and the effects of the consequential demand for wage increases. He would not agree that the increased prices we had received for our exports had been a cause of inflation.

137. While witnesses from the Treasury, Reserve Bank, and trading banks had all agreed that there was an excessive amount of money in circulation in New Zealand at the time they were speaking, Mr Young (although he was not completely consistent on this point) thought that there was insufficient money and that it would be foolish to take any measures to curb spending. In fact, with proper safeguards, the creation of debt-free money would, he thought, have made things better and costs lower. This is a very distorted view of the inflationary process. Traders could not pass on increased import prices and taxes or pay higher wages unless the public were able and willing to spend more than before.

138. The faith shared by most Social Credit witnesses who appeared before us that the issue of extra money would improve things in a period when resources were already fully employed seems to rest on several fallacies which are examined below:

Existence of a Chronic Gap

139. For most of the witnesses, this faith rests on the theory of a permanent "gap", for which we could find no justification.

No Difference Between Creation of Money and Taxation and Borrowing

140. Although the witnesses for the Social Credit Association did not fully share the views of some members of their movement that there was no inherent difference between the effects of the creation of new money on the one hand and taxation and borrowing on the other as a means of financing expenditure, they retained vestiges of this view, which we have criticised in the previous section.

Possibility of Spectacular Increase in Production

141. The social crediters seemed to foresee the possibility of a much more spectacular rate of increase of productivity than appears to us to be practicable in normal circumstances. The Association could not agree with the assertion in Mr Owen's book that *"two to four hours labour a week for men during twenty-five years only of their lives is sufficient to provide the total population with a very high standard of living and with complete economic security for all"*. But Mr Young envisaged an annual rate of increase of production of 10 to 15 per cent, although even between 1947 and 1954, when the rate of increase of productivity was high in comparison with pre-war figures, and also high by world standards, production per man-hour in New Zealand increased by only 2·4 per cent per annum. Indeed, in the last four years, the increase in production per man-hour has averaged less than 1 per cent per annum.

142. Asked why it was expected that production would increase so much more rapidly under a Social Credit regime, Mr Young said that, in the first place, people would have an incentive to work harder as a result of reductions in taxation; secondly, that producers would be encouraged by the *"better and surer market"* which would exist; and, thirdly, that the labour force would be increased by about 50,000 people by the removal of the means test for age benefits. In the absence of any research into the effects of taxation on incentives to work in New Zealand, it is impossible to reach any definite conclusion on Mr Young's first contention, but there is certainly no evidence to prove that reductions in taxation would achieve the results which Mr Young expects.

143. As far as the *"better and surer market"* is concerned, a major problem in recent years in New Zealand has been the ease with which manufacturers and traders sell their wares, so that they have been in a position to compete vigorously with one another for the available men and resources, knowing that they could pass on in prices the higher wages, or other costs which they have found it necessary to meet. In other words, the consumer has suffered because the market has been too "sure". Large issues of debt-free money would greatly aggravate this state of affairs. On this point, Mr Jordan quoted a letter from the New Zealand Manufacturers' Federation saying that production could be increased if there were a ready market, and that costs and prices would be lowered in many cases, if labour were available and restrictions against the working of shifts lifted. Mr Ashwin aptly described this observation as a *"blinding flash of the obvious"*.

144. We agree that there might be quite a substantial increase in the labour force if means tests were removed for age benefits. We doubt, however, whether the additional number would reach 50,000 as suggested by Mr Young, especially if his proposals to increase the benefits substantially were adopted. In any case, this could affect the rate of growth of production for only a year or two, and even in the first year could not increase production by an amount commensurate with the injections of money which were clearly contemplated under the original proposals of the Social Credit Association. In addition, Mr Young agreed that means tests for age benefits could be removed under the existing system, with similar results, if the Government so desired.

145. To sum up, we cannot accept Mr Young's assertion that *"nothing is impossible once you shake these financial leg-ropes off"*; nor

can we agree that, in the absence of revolutionary new techniques, production can be annually increased at anything approaching the rate of 10 to 15 per cent. **In our view, the factors limiting our ability to increase production since the war have been physical and psychological, not monetary.** Virtually no persons able and willing to work in New Zealand have been unemployed. No doubt people could have worked harder or done more to improve their capacity to make the best use of our inherited capital and natural resources. But that could have been achieved only through a change of attitude, not by putting into circulation large amounts of new money. More money will not of itself produce more goods.

Wartime Experience

146. Several Social Credit witnesses were most impressed by the fact that large quantities of money had been created in various countries during the war without driving up prices substantially. But we must remember that, in wartime, people were prepared to accept strict control over prices, wages and other incomes, rationing of foodstuffs, raw materials and equipment, and even direction of labour. Mr Young agreed that he would not like to see wartime control permanently maintained. In addition, in wartime, people accepted for patriotic reasons the necessity for shortages of goods and restraint in spending. These reasons lose driving force in times of peace. It is unrealistic to apply the experience of wartime to a peacetime economy.

Transfer from Capital Works to Consumer Goods Production

147. The Association's witnesses envisaged a substantial transfer of men and resources from capital works to the production of consumer goods. We agree that, if this were done, there would be a reduction of inflationary pressure. The difficulty is to select capital works which should be curtailed. The Association made no positive suggestions in this respect.

Cancellation of Debt-free Money

148. Miss King and Mr Young argued that the large sums of debt-free money which they had in mind would be issued in small quantities over the year and would be cancelled almost immediately after they had been issued. Mr Young recognised that the question of cancellation of any debt-free money issued by a Social Credit regime was *"of the utmost importance"*. In fact, he went so far as to say that it was *"fundamental"* to the Social Credit case. Recognising its importance, the Commission spent many hours examining witnesses for the Social Credit Association on the subject.

149. Miss King was completely unconvincing in her attempts to explain how the large amounts of debt-free money, once issued, would go out of existence. The Commission was first told that *"as consumer purchasing power, it* (money) *loses its virtue as soon as it is spent"* and that *"a consumer, by buying final goods, can take goods off the market and finally cancel the costs involved and included in their price"*. But she admitted that money issued remains in circulation, and is available for some one to exercise command over goods and services, until it goes back to its origin; the money remains in existence, she said, *"unless it is*

paid to extinguish a debt, and in a sense there is at present no technique for meeting what we call debt-free money, except in so far as the community always owes more debt to the banking system under present circumstances than it receives the means of paying".

150. From Miss King's attempts to show us how debt-free money would be cancelled, we were convinced that there would be no such cancellation by the means she described. Apparently Miss King has experienced trouble elsewhere in attempting to elucidate this matter, for she referred to the pains she had been at "*to try to understand the difficulties which the ordinary money mind and the business mind have in dealing with these things*".

151. We were not surprised when Mr Young told us that Miss King, "*not being too clear in the exposition herself*", had led us "*rather round the garden path or at least caused quite a considerable wandering round*". But his own explanation was no more convincing. He said that the "*same system of creation and cancellation*" would apply in a Social Credit economy as applied today, where "*the granting of an overdraft and the exercise of that by a borrower is creation of new money. And conversely, when that money is repaid, that money is automatically cancelled*".

152. We would make two comments on the foregoing statements. First, under the overdraft system in operation in New Zealand, repayment of an advance may, taken in isolation, lead to a reduction of the money supply as defined by the Reserve Bank. But the volume of purchasing power available remains unchanged unless, at the same time, the customer's overdraft limit is reduced – for he can draw cheques up to that limit at any time.

153. Secondly, there is an important distinction between bank advances and the issues of debt-free money envisaged by the social crediters. A bank advance is a loan, repayable by the borrower; an issue of debt-free money would not be repayable at all. It could, of course, be used to repay existing advances, but, if the large amounts of debt-free money which Miss King and Mr Young considered it possible to issue were used to repay advances, all present overdrafts would soon be paid off and this method of cancellation would no longer be available. However, Mr Young insisted that there would be no reduction of bank advances under Social Credit. Therefore any issue of debt-free money would increase the money supply by an equivalent amount, unless some of it were used for imports – but naturally our reserves of foreign exchange limit the extent to which this could be done.

154. If £80 to £90 million of debt-free money were issued in the first year of office of a Social Credit Government, the volume of money would by the end of the year have risen by about one-third. Even if the tax reductions and increased expenditure of the first year were merely continued and no further concessions made, a similar increase in the volume of money would occur in each subsequent year. Inflation of the money supply on this scale could not fail in the prevailing circumstances to lead to spectacular price increases and eventually to the destruction of our money system.

155. Mr Jordan, Mr Young, and one or two other witnesses with Social Credit affiliations recognised one other method of cancelling debt-free money; i.e., its retirement from circulation by taxation used to repay

debt to the central bank. Mr Jordan said that this would be necessary *"only in the event of some major upheaval or unforeseen circumstances, such as war, or earthquake"*. An attempt to issue £80 to £90 million of debt-free money per annum would, we are certain, create an inflationary situation which would have to be classed as a *"major upheaval"* – and the Social Credit Government would thus be forced to raise taxation and reduce expenditure once again to retire the surplus of money from circulation.

The Price Subsidy

156. In such a situation, Social Credit's other major *"safeguard against inflation"* – the price subsidy – would be of little avail. This measure, said Mr Young, would avoid any disastrous effects from the over-issue of money and *"prevent any pressure on prices upwards"*. But, on examination, the system of *"voluntary price regulation"* proposed would be quite ineffective if the money supply were inflated.

157. The scheme outlined to us by Miss King and Mr Young involved consultation between the Government and business, at which the businessmen would be asked to say what they considered was a reasonable margin of profit for the purpose of determining a fair market price. If they would then sign a contract to sell at a given percentage below the fair market price, the Government would subsidise them with debt-free money to the extent of the price reduction. If costs rose, prices would automatically rise to maintain the margin. Therefore, what is stabilised under this scheme is not prices, but the profit margins of traders dealing in the subsidised goods.

158. Mr Young was unable to say whether the subsidy scheme would extend over the whole range of traded goods and services and over rents and property values; or whether it would be confined to a few essential goods and services – this would depend partly on the size of the "gap" to be filled at the time. He agreed that, if only a few goods and services were subsidised, any excess purchasing power could be used to buy unsubsidised goods and services and the tendency would be for the prices of those goods and services to be raised. But even if everything bought and sold retail were brought within the scheme – and that poses administrative problems of great magnitude – it would still not provide a safeguard against a rise in prices. For traders and manufacturers would find it easy, in a situation of excessive money supply, to sell all they could produce and most would be eager to expand their turnover to increase their total profits; on the other hand, consumers, in this situation, would be faced with shortages of goods and services and they would not be unwilling to pay, and might even offer, higher prices. Therefore, there would probably be some dealing "under the counter" at higher than regulated prices, but more importantly, sellers would have every incentive to bid against one another for the limited supply of labour and resources available, even if this did involve higher costs. For, under this scheme, higher costs could always be passed on in prices; in fact, since the trader is allowed his costs plus a percentage margin, he has every incentive to inflate his costs in order to increase his total profits.

159. In reply to a suggestion that this might happen, Mr Young said that, if there were very grave shortages of goods, he would immediately ration to ensure equitable distribution. Also, if there were a steep increase

in costs, there would be a detailed investigation of the causes, and remedies (presumably much stricter controls over prices) applied to stop the increases.

160. Of course, excessive spending may take place, due not only to an increase in the volume of money, but also to more intensive use of the existing supply. For example, Mr Young was asked how he thought a Social Credit Government would deal with a situation where many people, fearing a rise in prices in the future, decided to spend more than their incomes by borrowing and/or drawing on their savings, thus creating excessive demand for the goods and services available. His answer was that, in such circumstances, it might have to resort to a policy similar to that which he considered appropriate in wartime, i.e. (a) appeals to save, (b) taxation to the extent thought just, (c) if necessary, freezing of certain money, and (d) rationing of essential goods, in addition to the price regulations which would already be operating.

161. Appeals to save would be of little avail if people expected the value of their savings to depreciate as the result of an excessive issue of debt-free money or if they feared that their savings might be frozen. In fact, if people generally came to fear the freezing of their savings, there would be a grave possibility of a "run" on the banks and of a general pressure to convert money into assets which the Government was unlikely to commandeer. To counter this, a Social Credit Government would have to adopt a policy of "bureaucratic regimentation" much more severe than this country has ever experienced in the past. Yet many social crediters complain of the degree of control existing today.

162. To sum up, we feel that an attempt to issue new money on the scale which most Social Credit witnesses seemed to consider possible and desirable would be certain, in circumstances where resources were already fully employed, to lead to a serious inflation of prices and force the Government either to withdraw the concessions given or to adopt direct controls which would be so widespread and so severe that they would be quite unacceptable to the people of New Zealand.

163. The Association's original submissions were clearly based on the assumption that the supply of purchasing power in New Zealand has been and remains inadequate. But we can only conclude from Mr Jordan's final address that the Association had by then come to the conclusion that New Zealand was suffering in current circumstances from excessive spending and an excessive supply of money. Indeed, Mr Jordan appealed to the Commission for a recommendation *"that the war against inflation be carried on"*. In addition, both Mr Young and he, in a supplementary submission made towards the end of our hearings, said that, in a period of inflation, they were not opposed to the methods specified from page 63 onwards of the Reserve Bank submissions, i.e., credit control by raising the reserve ratios and discount rate, and selective advance control. Mr Jordan stressed, however, that public co-operation in restraining spending and the possibility of increasing the production of consumable goods and services should not be overlooked as additional methods of control. These remarks indicate clearly the extent to which, by the close of our hearings, the Social Credit Association representatives had departed from the fundamental principles of their original submissions.

XI. Debt-free Money in the Future

164. As production and population grow, more money will be needed. Why, it may be asked, should not all the extra money we need in future be provided debt free to the Government, as many witnesses suggested, rather than through interest-bearing loans from the trading banks to industry? There are several reasons why such a course should not be followed.

165. We agree that there may be situations where what is primarily required is a direct increase in the incomes of consumers to absorb increased production and then it may be appropriate to issue additional money to the Government through the Reserve Bank; at other times, the primary need may be additional credit to assist producers to produce more, and we think that such funds are more appropriately provided by the trading banks who are in direct contact with individual producers and more conversant with their problems.

166. We do not favour undue reliance on the provision of new money through the issue of consumer credit; it seems to us that such a policy would mean that the community would receive too high a proportion of its income in the form of benefits from the State, unrelated to productive effort, and this would, in our view, unduly weaken the incentive to produce which is still so vital to our future progress.

167. It is an illusion to believe that costs and prices would be lower if all the extra money required as population and production expand were issued debt free through the Government to the people, rather than in the form of loans to industry and commerce by the trading banks. Firms need more working capital as their operations expand, and this necessity remains whether or not debt-free money is issued. Today, they obtain part of any extra working capital required by borrowing more from the banks. If, under a Social Credit regime, the banks could not expand their loans, the firms would have to obtain additional working capital either by raising their prices, increasing their capital, or borrowing at interest from other sources; no reduction in costs or prices could be expected.

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

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

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

(a) It would give a false picture of the real cost of Government operations.

(b) There would be pressure for the State to take over functions which it could perform no better than private firms.

(c) It would be very difficult to keep the issue of debt-free money within the bounds of prudence; and

(d) If an excessive issue were made, costs and prices would be driven up very steeply and rapidly.

XII. Insulation of the Economy Against Price Fluctuations Overseas

171. Mr Young, in his submission, claimed that it was essential that those engaged in the farming industries should be *"assured of a price in New Zealand money sufficient to meet the costs under which they must produce plus an adequate return for their own services"*. Discussion centred primarily around the application of this principle in the event of a fall in the prices of New Zealand's exports.

172. Miss King quoted a letter sent by Major Douglas to the Auckland Branch of the Farmers' Union in 1931 advocating that, in such a situation, subsidies should be paid to the exporter so that he could sell overseas at prices 10 per cent cheaper than his competitors in other countries. She said that this could be done in a future recession, finance being provided by an issue of debt-free money. The Commission asked whether this could be regarded as a fair way of competing in overseas markets; did we not object strongly to the disposal of American food surpluses overseas at low prices? Later, Miss King said that she would not favour a subsidy to facilitate the sale of exports as a general policy.

173. Mr Young complained that the support prices proposed in New Zealand for meat and wool were, in his opinion, quite inadequate to cover farm costs and give the farmer a reasonable profit, and that a sharp fall in prices could thus have serious repercussions on the New Zealand economy. He seemed to feel that farmers should be guaranteed a price at approximately the level ruling when he spoke. He was not prepared to extend this principle to other sections of the community. The farmers were the providers of the overseas exchange of New Zealand and their receipts depended on factors beyond New Zealand's control. As such, they deserved special treatment.

174. Mr Young stressed that, under a Social Credit regime, farm prices would be related to internal costs. Presumably then, if overseas prices rose more rapidly than internal costs, some income would be taken from the farmer. When overseas prices fell, he would receive payments sufficient to cover costs plus a reasonable profit. New Zealand's experience in recent years has shown that there are practical and political difficulties in the implementation of such a policy, e.g., it is difficult to arrive at an average cost of production on which to base the payment to farmers and there are always objections to the withholding of funds from the farmers in a period of rising prices.

175. Also, under examination, Mr Young recognised that overseas market trends could not be completely ignored. For example, he agreed that if the market for one product fell off, it was desirable for production

to be switched to more profitable lines. He said that farmers producing the goods whose price had fallen would be encouraged to switch although, pending transfer, they would receive their full cost, plus a reasonable profit, from debt-free money. Farmers would not be directed to change production, but they could not expect financial help to continue if they persisted in producing things which were not wanted.

176. We would observe that market trends overseas could not be ignored completely if the prices of all New Zealand's export products fell drastically. Although, in such circumstances, import prices would be likely to fall also, they would probably fall less than export prices if past experience can be taken as a guide. Thus, each unit of goods exported would be exchangeable for a lower volume of imports than before. The total volume of imports could be maintained for a time by drawing on our foreign exchange reserves, but if the fall in export prices persisted, it would eventually be necessary to reduce imports. Mr Young acknowledged that no administration could prevent a decline in New Zealand's standard of living if this should happen.

177. Mr Young was questioned on the danger of inflationary pressure arising as a result of maintaining domestic incomes while the volume or value of imports fell off. He replied that this could be avoided by *"voluntary price regulation"*, by the use of any surplus reserves of foreign exchange, by some switch of production from capital to consumer goods, and by avoiding an over-issue of money. Towards the end of his evidence, Mr Young said that if the gap was not sufficient to justify financing subsidies out of debt-free money, he would *"tax or stop some other work in favour of this particular purpose the money is required for"*. The statement indicates a notable departure from the fundamental principles of the Association's original case, and the adoption of a view much more in line with current financial opinion.

XIII. Social Credit, International Trade, and Control by the State

178. Both Miss King and Mr Young stated that import selection would be an essential element of Social Credit policy. It would be necessary to prevent excessive spending on imports and to ensure that, if overseas funds were scarce, those imports which were least essential to the New Zealand economy would be excluded.

179. We would make two comments on the foregoing statement. First, a system of import selection would not be sufficient to safeguard our foreign exchange reserves if the money supply were excessively inflated; for such inflation would mean that costs in the export industries would be driven up in relation to prices received for exports and these industries would become less attractive in relation to those producing predominantly for the home market. Unless exports were subsidised, the tendency would ultimately be for the volume of exports to decline, thus reducing our earnings of foreign exchange. At the same time, the demand for foreign exchange would be increased as a result of domestic inflation and the difficulty of administering the controls would be considerably increased.

180. Secondly, this is another of those direct controls by Government to which the Social Credit Association and the Social Credit Political League have declared themselves opposed in principle. Mr Young was unable to point to any control in existence today which Social Credit

could abolish. In fact, his evidence showed that control by the State would be expanded considerably. Not only would we revert to a system of detailed import selection and exchange control, but we would also have comprehensive price regulation and a much stricter control of bank advances; probably control of building, interest rates, and rents; and possibly, in an emergency, rationing plus the freezing of certain money holdings. If the views of those with more grandiose ideas than the Association about issuing debt-free money were accepted by the Government, the country, in our opinion, would soon have to be subjected to even more rigid controls, conceivably even including the direction of labour, in order to hold down costs and prices and preserve a measure of equity in the distribution of the available goods and services.

181. We do not intend in this report to discuss the ultimate objectives of Social Credit but if, as Miss King said, two of the long-term aims of social crediters are the replacement of wages and salaries by a universal national dividend and the abolition of interest, we cannot see how at the same time they could preserve a system of private ownership and private enterprise. The two former objectives are completely incompatible with the third.

XIV. Summary and Conclusion

182. It was apparent from the remarks of counsel for the Social Credit Association in opening his case that the version of Social Credit put before the Commission by the Association was designed to avoid some of the more extravagant features of that put to the electors of New Zealand by the Social Credit Political League in 1954. It was also more cautious than that advanced by most of the other witnesses who appeared before the Commission and who claimed to be social crediters. Even in its original submissions the Association gave us no assurances of the speedy abolition of debt and taxation or of the practicability of the institution of a universal national dividend financed from debt-free money. In the early stages, the representatives of the Association maintained a firm conviction that there was a large gap to be filled between purchasing power and prices, which would justify an issue of debt-free money by the Government to enable taxation to be reduced, subsidies to be paid to retailers, social security benefits to be increased, and non-commercial works to be financed without an increase in the public debt. But no attempt was made to measure the extent of the alleged gap, and under examination Mr Young admitted that all the previous estimates which had been made were full of serious errors. There was no readiness to assert that it was safe to issue £90 million or £190 million of debt-free money at the present time and in fact, in evidence, Mr Young said that it would be a mistake to promise any reduction of taxation or increase in benefits.

183. The original convictions of the Association's witnesses about the gap and its size obviously weakened as our hearings proceeded. Major Douglas's "A + B theorem" upon which most Social Credit literature in the past has relied to prove conclusively the extent of the alleged chronic gap, and which still formed the basis of the representations of some of the other Social Credit witnesses, is now regarded by the Association as being *"of academic interest"* only. In their submissions it was made clear that the belief of the Association's representatives in the existence of a

chronic gap rested primarily on *"evidence from experience"*, namely, the occurrence of depressions in the past and the growth of debt in New Zealand since 1936. But under examination their faith in this evidence practically disappeared; for instance, towards the end of our hearings, Mr Jordan admitted that *"increases in debts, public and private, are neither a measure of the 'gap', nor conclusive proof of it"*. Indeed, he went so far as to say that the Association does *"not postulate a chronic shortage of purchasing power"* and asked us for a recommendation that *"the war against inflation be carried on"*.

184. The only positive suggestion which the Association recommended to us for immediate application was that a National Credit Authority should be set up and a national survey made to ascertain, *inter alia,* whether or not a gap existed. It was clearly indicated that the soundness of the remedy which they proposed for later application – the issue of debt-free money to finance various items of Government expenditure – depended on the demonstration of a gap. Miss King and Mr Young agreed that, if the case for the gap failed, the case for the application of Social Credit failed.

185. No Social Credit witness produced evidence to satisfy us of the existence of a gap, chronic or temporary, at the present time. In fact, as indicated above, the Social Credit Association appeared to have realised by the end of our hearings that New Zealand is currently suffering from an excess, not from a shortage of spending power. In such circumstances, there is nothing to warrant the adoption of Social Credit's financial proposals. We are convinced that implementation of the proposition of some witnesses that all Government expenditure should be financed with debt-free money would result in disastrous inflation.

186. The main submissions made by counsel for the Social Credit Association in his final address were that it was necessary to have a national survey and to set up an authority *"to watch carefully inflation and deflation and to take the appropriate steps in the case of imbalance"*. These recommendations are discussed in other sections of our report dealing with research and statistics and with the co-ordination of policy. The principal surviving variation in the Association's case from generally accepted financial opinion was that, if there were justification in the future for an issue of new money, this should preferably be made debt free to the Government to pass on to consumers or to finance non-commercial works. We do not favour this proposal. To believe that it would reduce costs, prices, and total indebtedness is illusory. Moreover, it would give a completely false picture of the real cost of Government works and would be a potent inducement to extravagance in the granting of benefits and tax concessions.

187. The Association's final views were substantially different from the submissions which the Association originally presented, and from the version of Social Credit advanced by most other witnesses, which followed more closely the traditional doctrine of a chronic gap. It is not surprising that this doctrine should have flourished during a depression. In a period when large numbers of people are unemployed, wages and prices are falling, and considerable stocks of goods are unsold, there is every reason to believe that placing more purchasing power in the hands of the people will improve the operation of the economic machine. But, as changes in the Association's attitude show, it is impossible to sustain

a contention that there has been a general shortage of purchasing power during a period when there has been virtually no unemployment, a very large number of employment vacancies, recurrent shortages of goods and services, and continually rising prices.

188. Perhaps the continuing belief of many witnesses that the issue of large quantities of new money would be beneficial in such a period rests mainly on a confusion between what is good for the individual and what is good for the community as a whole. We know that if, as individuals, we won a lottery or received a substantial increase in pay, we could buy more of what we want. But if an issue of debt-free money for tax reductions or increased benefits gave us all the equivalent of a lottery prize or a pay increase, no-one would be better off at a time when labour and resources were fully employed. The issue of debt-free money in such circumstances would not enable any more goods or services in the aggregate to be provided.

189. The additional money would not remain unspent; nor would it be cancelled out of existence as soon as it was spent as some witnesses contended. We would merely have much more money chasing a relatively constant supply of goods and services. Inevitably prices would be driven up by extra competition for the things which were available for sale. If the tax concessions and increased benefits were repeated in subsequent years, necessitating further issues of debt-free money, the country would be engulfed in a rapid inflation, bringing in its train economic, political, and social problems of a magnitude and severity which it is to be hoped New Zealand will never be required to face.

NOTE 1 TO APPENDIX E

Points of Difference Between Witnesses for the New Zealand Social Credit Association and the Book How Social Credit Works *Compiled by Mr Wilfrid B. Owen*

(Reference paragraph 6 of Appendix E)

190. In view of the difficulty which the Commission found in reconciling the views expressed by witnesses for the Social Credit Association with published Social Credit literature – in particular with the book *How Social Credit Works* compiled by Mr Wilfrid B. Owen, President of the New Zealand Social Credit Political League – Mr R. G. Young, Vice-President of the League, agreed, in response to a request from the Commission, to state concisely the points of difference. These are set out herewith.

191. *How Social Credit Works,* page 29:

The Social Credit idea is that, under modern conditions, complete employment in Industry is neither possible nor desirable; that the national dividend must progressively replace the wage and salary; that credit must be issued free to consumers to bridge the gap between purchasing power and prices, and that this Consumer Credit shall be the controlling factor in Distribution.

Mr Young:

Our comment is that that is not practicable in New Zealand, that full employment is necessary and desirable in this country, and that we see nothing in the foreseeable future that the national dividend would replace the wage and salary systems.