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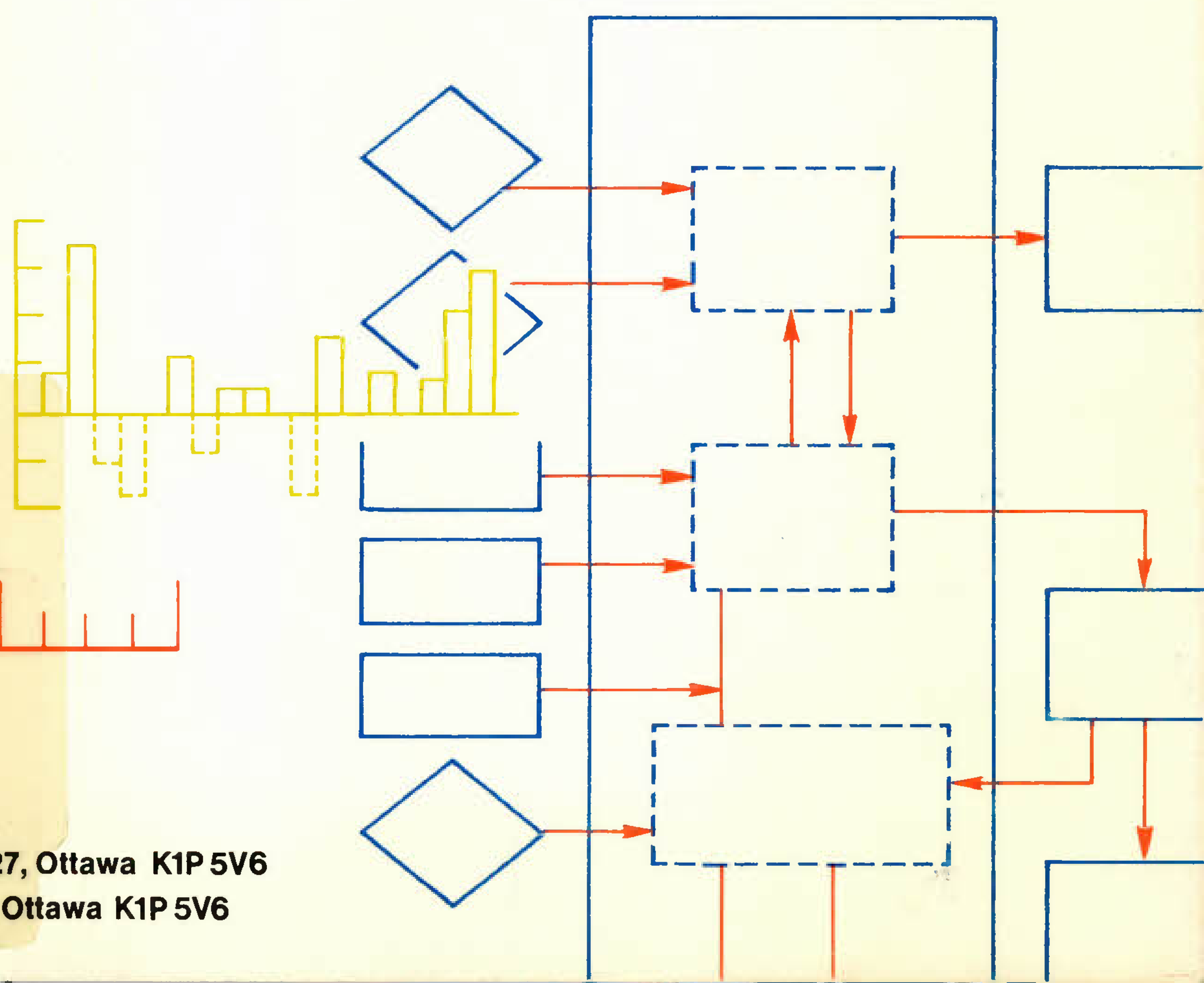

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DISCUSSION PAPER NO. 62

Current Banking Policy and Practice in the United Kingdom, West Germany and Australia

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September 1976

RÉSUMÉ

L'objet premier de ce document est de décrire et d'évaluer les changements apportés à la structure bancaire du Royaume-Uni, de l'Allemagne de l'Ouest et de l'Australie, depuis le milieu des années 60, et d'indiquer quelques-unes des leçons qui se dégagent de cette expérience. L'objectif secondaire est de fournir une aide à l'évaluation des points forts et des lacunes du système financier canadien.

ROYAUME-UNI

En septembre 1971, le Royaume-Uni a entrepris une importante réforme de son système de contrôle monétaire. Celle-ci consistait en plusieurs parties reliées entre elles. Premièrement, on a accordé moins d'importance qu'auparavant au crédit bancaire destiné au secteur privé, et une plus grande importance aux grands agrégats monétaires. Deuxièmement, les contrôles directs sur les prêts bancaires ont été éliminés. Troisièmement, on a mis un terme aux arrangements visant le cartel bancaire. Ces dernières mesures étaient destinées à promouvoir une concurrence plus libre sur les marchés financiers, et à permettre de recourir davantage aux contrôles monétaires reliés au marché, c'est-à-dire les réserves obligatoires, l'escompte et les opérations sur le marché ouvert. Ces modifications ont également été accompagnées d'une politique plus flexible en matière de taux d'intérêt et d'un changement

d'approche de la stratégie officielle concernant la gestion de la dette.

A l'heure actuelle, la Grande-Bretagne compte principalement sur les instruments de contrôle monétaire orientés vers le marché. Bien que les contrôles directs n'aient pas été entièrement abandonnés, le nouveau système de réglementation s'est révélé un stimulant appréciable à la compétitivité et à l'efficacité du secteur bancaire.

ALLEMAGNE DE L'OUEST

Dans la République fédérale de l'Allemagne de l'Ouest, l'ordonnance sur les taux d'intérêt fixant les taux maximaux d'intérêt débiteur et créditeur a été abrogée en 1967. A l'heure actuelle, les seules contraintes sont celles qui sont imposées par le marché et le coefficient coûts/revenus de chaque banque.

Au cours des dernières années, les banques universelles de l'Allemagne se sont appliquées à faire face à une plus forte concurrence et à de plus grandes exigences de la part des clients. En outre, les banques allemandes ont maintenu leurs rapports étroits avec l'industrie, et se sont également implantées à l'étranger. En conséquence, l'efficacité et la rentabilité des banques se sont améliorées. Il en est de même de la solvabilité du système bancaire allemand.

AUSTRALIE

Au cours des quelque dix dernières années, le système bancaire mixte de l'Australie a exercé son activité dans une atmosphère plus libérale. Cette nouvelle liberté a conduit toutes les banques à améliorer leurs produits et à introduire des innovations visant à réduire les coûts. Même s'il leur est interdit d'établir des succursales directes, quelque 100 banques étrangères ont exercé une influence énorme sur la scène bancaire australienne. D'autre part, les banques commerciales de l'État n'offrent pas aux autres une concurrence sérieuse.

Les banques australiennes sont très conscientes de leurs responsabilités envers la collectivité qu'elles desservent.

CONCLUSION

Les progrès évoqués dans ce document indiquent clairement que la tendance à la banque multinationale géante intégrée et universelle est irréversible et bénéfique.

A B S T R A C T

The primary objective of this paper is to describe and evaluate the changes that have occurred in the banking structure of the United Kingdom, West Germany and Australia since the mid-sixties, and to note some of the lessons that obtain from this experience. The secondary purpose is to help in evaluating the strengths and shortcomings of the Canadian financial system.

UNITED KINGDOM

The U.K. launched a major reform of its monetary control system in September 1971. It consisted of several related parts. First, there was a de-emphasis of bank credit to the private sector and greater weight given to the broad monetary aggregates. Second, direct controls on bank advances were eliminated. Third, the bank cartel arrangements were terminated. These latter moves were designed to promote freer competition in financial markets, and pave the way for greater reliance on market-related monetary controls, i.e. reserve requirements, discounting and

open-market operations. The changes were also accompanied by a more flexible interest rate policy and a shift in official debt management strategy.

Britain now places prime reliance on market-oriented monetary control tools. While direct controls have not been entirely abandoned, the new regulatory system has given substantial stimulus to competitive and efficient banking.

WESTERN GERMANY

In the Federal Republic of West Germany, the interest rate order, which fixed maximum debtor and creditor interest rates, was revoked in 1967. Now the only constraints are those imposed by the market and the cost/earnings ratio of each bank.

Germany's universal banks have in recent years adapted themselves to heavy competition and more sophisticated customers. In addition, German banks have maintained their close relationship with industry, and have also moved abroad. In consequence, banking efficiency and profitability has improved. So has the soundness of the German banking system.

AUSTRALIA

In the past decade or so the Australian mixed banking system has worked in a more liberal atmosphere. This new freedom has led all banks to implement product improvements and cost-reducing innovations. While barred from setting up direct branches, some 100 foreign banks have exerted an enormous influence on the Australian banking scene. On the other hand, state trading banks do not offer serious competition to the other Australian banks.

Australian banks manifest a high degree of awareness about their responsibility to the community as a whole.

CONCLUSION

The developments traced in this paper strongly indicate that the trend towards the giant universal integrated multinational bank is irreversible and beneficial.

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PREFACE

> "Then I began to think, that it is very true which is commonly said, that the one-half of the world knoweth not how the other half liveth".
>
> François Rabelais (1494-1553)
> Gargantua

There is probably little need to stress the value of looking upon our own economic organizations from the outside; no device is more helpful to our understanding of the way things are done in this country than to consider alternative ways of doing the same things. Moreover, in judging the performance of an economic institution, the comparative approach is vital, since statements can be made only in relative terms.

During the past decade, I have surveyed the banking systems of nearly eighty countries, some several times, and in the summer of 1973 I gathered the material for this paper which had been commissioned by the Financial Markets Study Group of the Economic Council of Canada as part of its research covering deposit-taking institutions.

Given that "theoretical insight in monetary and financial matters depend greatly on knowledge of the institutions and markets which make up the financial system" (Jack Revell, The British Financial System, 1975), this paper concentrates on the structure, conduct and performance of the various financial markets and their participants in the United Kingdom, Western Germany and Australia. Since it was produced early in 1974, I have added three appendices which have extended the coverage of this paper up to mid-1976. Since its release is scheduled to coincide with the discussions on the 1977 revisions to the Bank Act, it is hoped that it will help interested observers in evaluating the strengths and shortcomings of the Canadian financial system.

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August 1976

CURRENT BANKING POLICY AND PRACTICE IN THE UNITED KINGDOM, WEST GERMANY AND AUSTRALIA

In recent years the question of the efficiency of the financial system has received considerable attention in several countries. Not surprisingly, the upshot of these studies is that a community has as much right to demand efficiency of its financial market institutions and arrangements as from other sectors of its economy.

It may be worth recalling that the primary functions of financial institutions and markets are to provide a payments mechanism for domestic and foreign transactions and a transfer mechanism for the allocation of surplus funds of lenders between competing borrowers. The efficiency with which the financial system carries out these two tasks is difficult to assess. But one broad test is the cost involved in financial intermediation. This is usually taken to be the spread between the rates paid by financial institutions to "surplus units" or "ultimate lenders" and the rates paid to these intermediaries by "deficit units", although in many financial institutions there are significant costs apart from interest involved in obtaining funds. Clearly the narrower the differential, the greater is the operational efficiency of intermediation. The quality of credit management is also important, as is the ability and willingness of intermediaries to adjust to the changing needs of their customers. Another material consideration is the need to provide a sufficient volume of risk funds. This requirement is largely met by a well organized new issues market and by financial institutions possessing the necessary ingenuity and disposition to accommodate the legitimate needs of the general community, in particular servicing specific business propositions where the margin of security for a variety of reasons is less than is usually called for. This demands considerable competence and very often acceptance of a higher risk factor.

An alternative way of describing the importance of a well-functioning financial system is to recognize that the financial sector uses a certain part of the community's stock of labour and capital inputs and materials; operational efficiency is achieved when the minimum amount of these resources is required to produce the given output of financial services. Greater efficiency is also obtained when the scarce loan and equity funds mobilized by financial institutions go to their most efficient uses (i.e. to those projects having the highest net productivities). In other words, an efficient finance industry provides the best range of services at the lowest resource cost. This in turn enables an economy to meet more of its demands for consumption, leisure, capital formation and community goods.[1]

The financial systems of the United Kingdom, West Germany and Australia have changed considerably in recent years.

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[1] These matters are discussed in some detail by Dr. D.W. Stammer "Causes and Effects of Changes in the Capital Market" in Economic Papers (The Economic Society of Australia and New Zealand), January 1973, pp. 1-12. See also, R.R. Hirst "The Implications of Recent Inquiries into Capital Markets in Australia and Overseas", ibid, pp. 13-23.

The volume of funds flowing through their respective financial systems has greatly increased. New financial arrangements have been introduced. New types of financial institutions have formed and grown rapidly and established intermediaries have taken on new functions. The traditional demarcation lines between banking and finance and industry and commerce have become blurred. There is a closer involvement with foreign financial institutions and with the international financial market. The purpose of this paper is to describe and analyze these changes with a view to suggesting what Canada can learn from the experiences of the U.K., Germany and Australia and also what wider lessons may be derived from such a comparative study.

THE UNITED KINGDOM

Aside from the merger between National Provincial and Westminster Bank, and the decision by clearing banks to publish 'true' profits and reserves in 1969, little occurred to change the face of commercial banking in Britain until "new arrangements for the control of credit" came into effect in mid-September, 1971. But before discussing these new measures, a brief review of the superseded system may be appropriate.

The Old System of Credit Control

Under the preceding regulations the British banking system was controlled by the Bank of England by liquidity requirements supplemented by quantitative and qualitative prescriptions on bank credit. The large deposit banks that are members of the

London Clearing House (Barclays, Lloyds, Midland, National Westminster, etc.) and the Scottish banks (The Bank of Scotland, The Royal Bank of Scotland and the Clydesdale Bank) were expected not to allow the ratio of their liquid assets to gross deposits to fall below 28 percent of which 8 percentage points was to be represented by cash, i.e. notes in tills and balances at the Bank of England. The liquid assets consisted of cash, money at call and short notice and bills of exchange, including Treasury bills. The regulation of this liquidity was affected through purchases and sales of Government securities by the Bank of England (i.e. open-market operations) and by the call for or the repayment of Special Deposits by the central bank.

Credit control through the observance of quantitative limits was provided by ceilings placed on each clearing bank's sterling loans. The ceilings were calculated on the basis of the loans made by each institution on a particular "making-up" day. The qualitative controls were accomplished through guidelines issued by the Bank of England to the clearing banks indicating the order of priority in which various types of loans might be satisfied. Export credits were usually given the highest priority followed by credits essential to industrial production, with consumer credit at the bottom of the list.

The Background to the New Monetary Arrangements

To put the new system of credit control into perspective, it is necessary to review briefly the origins of the new approach.

As long ago as 1963, Lord Cromer, then Governor of the Bank of England, asked whether the British banks were serving the 20th century as well as they had served the needs of past centuries. It is fairly certain that the National Board for Prices and Incomes didn't think so, because in its Report on Bank Charges, published in May 1967[2], it argued that the inter-bank arrangements, under which London and Scottish clearing banks agreed among themselves both the maximum rates they would pay on deposits and the pattern of loan and overdraft rates they would charge to various classes of borrowers, meant that competition between the banks did not extend to prices; and that the long-standing cartel had led to a loss in the banks' power to attract deposits and hence to a loss in their relative position in the financial system. The PIB report also pointed out that increases in Bank rate automatically added an "endowment element" to the banks' profit - the additional windfall that accrued to the lending banks whenever there was an increase in Bank rate. With loan interest rates being geared directly to Bank rate, any increase had a corresponding effect on the rates charged to borrowers and this more than proportionately off-set the additional interest payable on deposit accounts (the element of customers' current account deposits in bank assets not bearing interest).

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[2] Great Britain, National Board for Prices and Incomes, Bank Charges, Report number 34, Cmnd. 3292 (London: Her Majesty's Stationery Office, 1967).

Among other things, the report recommended that the inter-bank agreements on deposit and lending rates should be abolished; that the tight link between these rates and Bank rate should be loosened; and that all deposit-taking institutions should be subject to liquidity ratios requirements similar to those imposed on the clearing banks. It also recommended that the Government should aim at ensuring complete disclosure of profits and reserves by clearing banks "as soon as practicable", and should consider a system of compulsory deposit insurance.

At the time of its publication the PIB report provoked relatively little public discussion, and it was cooly received in both official and banking circles. Indeed, one year later, in evidence to the Monopolies Commission, individual banks suggested that without the collective agreements on interest rates, "they would end up paying more for the deposits they already receive and would therefore be unable to finance industry and commerce so cheaply." The Governor of the Bank of England was reported to have "accepted these arguments" and the Treasury representatives "went further and said that they would wish the present arrangements to survive because they believed that they enabled the major part of the credit requirements of the country's industry and commerce to be satisfied at lower rates than would otherwise be the case." It also appears that "any success achieved by the clearers in winning deposits away from institutions in the public sector, e.g., the National Savings Bank, would hardly have been welcomed by the authorities."[3] Thus the Monopolies Commission reporting in 1968, that the cartel agreement on interest rates had such a 'soporific' effect on the banks that it must be abolished if they were to become more competitive, made it clear that, since the system suited the authorities, there was little scope for the banks to introduce the major changes urged upon them by their critics.

As time passed, however, the authorities became increasingly unhappy about the effects of monetary policy. In the period 1950-70 the deposits of the London clearing banks rose by 80 percent, whereas the trustee savings banks (ordinary and special investment departments) increased by 179 percent, and the building societies deposits by a remarkable 770 percent. During the same period clearing bank advances grew by 256 percent and those of the building societies by 726 percent.[4] It should be added that the sterling deposits of the U.S. banks in London increased threefold between 1965 and 1970, while clearing bank deposits rose by one-fifth. In short, the operation of monetary policy discriminated against the large deposit banks and significantly inhibited their development. These changes, in turn, served to undermine the framework of central bank control.

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[3] W.B. Davidson "Competition and Credit Control : A Commercial Banker's View", Journal of the Institute of Bankers, London, December 1971, p. 377.

[4] Ibid, p. 379

The disadvantages of the quantitative controls were also becoming increasingly evident and recognized. For one thing, the bank lending ceilings were hampering competition and innovation. As a result, the efficient banks were prevented from growing and the less efficient were helped to maintain the level of their business. Similarly, qualitative controls distorted the pattern of lending and tended to favour the business borrower at the expense of the personal customer.

Furthermore, these ceiling controls were ineffective because they led to a fair amount of disintermediation (i.e. the flow of saving directly into credit market instruments rather than through financial intermediaries). In particular, they encouraged the growth of a considerable inter-company capital market in which the writ of the Bank of England's moral authority did not carry much weight. The effectiveness of the ceilings was also seriously blunted by the rapid growth in the size and importance of the Eurodollar market. Many large firms which found themselves unable to borrow from their banks through the normal machinery of sterling loans and overdrafts (because the lending bank was at or near its ceiling), found it possible to borrow Eurodollars at favourable rates, convert these into sterling and make the appropriate provisions, through the forward exchange market, to repay the Eurodollar loan at maturity. It suffices to note that recourse to this form of finance reached such dimensions that in the Spring of 1971, the Bank of England had to ban all Eurodollar loans of this kind if the indebtedness was incurred for a period of less than five years.

Still further weaknesses in the old system of credit control in Britain arose from the Bank of England's operations in the market for Government securities generally known as the gilt-edged market. The main consideration of the Government broker (a representative of a firm of stockbrokers who acts for the Bank of England) was to protect and ensure the marketability of Government obligations. When gilt-edged securites were offered in large quantities, whether by banks or other institutional investors, the Government broker could be relied upon to buy them, though often at prices below those prevailing before the securities were offered. This preoccupation with the funding of the National Debt, rather than with the effect on the credit base meant that official operations in the gilt-edged market could and often did, lead to changes in the supply of money and credit that were the reverse of those required by the prevailing economic situation.

Before leaving this description of some of the main elements in the situation leading up to the initiation of new techniques of monetary policy, it should be pointed out that the large clearing banks began to compete with the other banks even before the abandonment of the cartel agreement and the quantity controls in the autumn of 1971. This was brought about through the formation of special subsidiaries which were prepared to pay market rates for fixed deposits of a certain size.

These subsidiaries were not subject to the rules of the cartel. They were moreover able to engage in medium term lending as a counterpart to their ability to borrow money on fixed and lengthy terms. Thus, in practice, the clearing banks were operating a divided structure, the main taking of deposits and relatively traditional forms of lending being done through the parent institutions, with their widespread branch systems, and the competitive taking of large deposits at higher rates for less orthodox and more varied forms of lending being undertaken by subsidiaries, usually operating from a single office.

Another impetus to competition was the decision by the London and Scottish clearing banks in 1969 to cease to avail themselves of the provisions of the Companies Act, on non-disclosure of true profits and reserves. Following that resolution a new spirit appeared to spread through the major deposit banks, evidenced by greater attention to profitability. It may be worth noting here that one U.K. authority has reached the conclusion that:

> "By putting profitability rather than size or some notion of public service in the centre of banking objectives, disclosure appears to have had two contrary effects. On the one hand it has strengthened the forces making for innovation; on the other it seems also to have reinforced the eventual tendency

> discernible in recent years, for the banks to exploit their oligopolistic position more by taking advantage of the ceilings on lending and of the widening margin between Bank rate and long-term industrial loan stock yields to raise overdraft rates in relation to Bank rate."[5]

Be that as it may, it is still true that competition within the banking system and between banks and other institutions had been growing over the 1960's, and in the process the agreement on interest rates had been subject to increasing strain.

This was the situation that prevailed over nearly a quarter-century. The desirability of combining an effective measure of control over credit conditions with greater scope for competition and innovation became increasingly apparent. As was stated by the Chancellor of the Exchequer in his Budget speech in March 1971, "..it should be possible to achieve more flexible but still effective arrangements by operating on the banks' resources rather than by directly guiding their lending." Two months later, the Governor of the Bank of England said:

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[5] Professor Harold Rose, "Competition and Credit Control: The New Framework". The Three Banks Review, March 1972, pp. 6-7.

> "..We must beware of believing that if we do succeed in restraining bank lending we have necessarily and to the same extent been operating a restrictive credit policy. We may by our very actions stimulate the provision of credit through non-bank channels; we may introduce distortions into the financial system; and we may indeed be distorting in harmful ways the deployment of the real resources of the country."[6]

This last point was made even clearer when the Governor said:

> "It is obvious that physical rationing of (credit) can lead to serious misallocation of resources, both in the economy and in the financial system, and that inhibiting competition between banks can do much damage to the vigour and vitality of the entire banking system."[7]

To conclude: the authorities presumably now accepted the argument that lending ceilings stifled competition between the banks and discriminated unfairly against them as a whole and also were prepared to see greater movements of interest rates throughout the whole banking system.

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[6] Speech by Governor of the Bank of England, delivered at the International Banking Conference in Munich on May 28, 1971.

[7] _Ibid._

The New System of Credit Control

On September 16, 1971, there was erected a new framework for monetary policy and banking practice, the initial design for which was presented (as a basis for discussion) in May in the Bank of England's so-called "Green Paper" on "Competition and Credit Control". The main feature of the new scheme is that the discipline of credit control through reserve ratios is extended to all banking institutions, including foreign, overseas and merchant banks. In place of the previous minimum liquid asset ratio of 28 percent, to which the clearing banks only were subject, all banks are to maintain (on a day-to-day basis) 'eligible reserve assets' equal to at least 12½ percent of their 'eligible liabilities'. The clearing banks also agreed to maintain a daily level of balances with the central bank equal to 1½ percent of their 'eligible liabilities'. This replaced the former 8 percent cash ratio, in which, unlike the new arrangements, cash in tills was included.

Quantitative controls were abolished and qualitative instructions were withdrawn. Significantly, the Bank of England reserved the right to give qualitative guidance on bank lending.

The clearing banks' agreement on interest rates was abandoned. Accordingly, each bank now quotes its own deposit rate for seven-day money and other terms. On the lending side, each bank now quotes rates expressed in relation to a published 'base rate' determined by itself individually in the light of commercial and market considerations. Parenthetically, base rate may be compared to the 'prime rate' used in the United States. Two observations are worth stressing within this context. First, with the abandonment of the inter-bank agreement on interest rates, the direct link with Bank rate also came to an end. In consequence, the significance of Bank rate as a conventional reference point for other money market rates was reduced. Or to put the same point another way, the new system deprived the authorities of some of their former control over interest rates, especially at the short end. Second, the new system came into effect without some equivalent of the U.S. Regulation Q, which limits the rates that American banks can offer for time and savings deposits. Indeed, the Bank of England went out of its way to state, in the explanatory memo it issued at the inauguration of the new scheme, that "the authorities see no need, at least in present circumstances, to seek to limit the terms offered by the banks for deposits to protect the position of the savings banks and building societies." Even so, the Bank reserved the right to limit the competition offered by the clearing and other deposit banks for savings deposits.

The discount houses, discount brokers and the money trading departments of certain non-clearing banks agreed to maintain at least 50 percent of their borrowed funds in certain categories of public sector debt. These include Treasury bills and Government securities with not more than five years to maturity. The long-standing practice of tendering for Treasury bills at a common,agreed price was abandoned. Each discount house now tenders individually. There is still an undertaking by the Bank of England to confine lender-of-last-resort facilities to the discount houses, so that they will continue, as their side of the bargain with the authorities, to cover each week the amount of Treasury bills on offer.

Installment credit finance houses, except for those with 'eligible liabilities' of less than 5 million pounds, are now subject to a minimum reserve asset ratio of 10 percent. Eligible liabilities exclude deposits having an original maturity of over two years and any amounts borrowed from the banks (an exclusion analogous with inter-bank lending). Reserve assets to be held by the finance houses are identical with those required by the banks.

All banks and finance houses may be compelled to lodge Special Deposits at the Bank of England. These are not eligible reserve assets and will carry interest at the Treasury bill rate. The proportion of eligible liabilities that may be required to be placed in Special Deposits will be uniform for all banking institutions and finance houses; but the Bank of England reserves the right to impose different rates in respect of resident and non-resident deposits. In this way the Bank will be able, if it so wishes, to influence the movement of international funds.

What is more significant is that the Bank of England modified the extent of its operations in the gilt-edged market. Sometime before the publication of Competition and Credit Control, "the conclusion had been reached that the Bank's operations in the gilt-edged market should pay more regard to their quantitative effects on the monetary aggregates and less regard to the behaviour of interest rates".[7] In application of this conclusion, the Bank of England announced in May, 1971 that it would no longer provide 'outright support' for gilt-edged stocks having a maturity of over one year. In future the authorities would "not normally be prepared to facilitate movements out of gilt-edged by the banks, even if their sales should cause the market to weaken quite sharply". Expressed in another way, the Bank reserved the right to make outright purchases of Government stock with more than a year to run at its discretion and initiative. This meant that holders of gilt-edged stock, including the banks could no longer depend on their unconditional saleability at prices close to those current in the market.

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[7] Speech by the Chief Cashier of the Bank of England, J.B. Page, to the Institute of Bankers, London, November 10, 1971.

A final point should be made here. The foregoing changes represent a radical alteration in the operation of monetary policy in the United Kingdom, and more specifically in the methods of control of British financial institutions. Yet it is also true that these sweeping reforms have not been the subject of a single clause of legislation. Parliament barely discussed them. They have all been fixed up as a gentlemen's agreement in private conclaves in the City of London, the heart of the U.K.'s financial dealings. Truly a remarkable example of the traditional informality which characterizes credit control in Britain. But more of this later.

Further Measures

One year after the Bank of England had announced and put into effect its new policy in the gilt-edged market, the market encountered massive selling,[8] and the yields on short-dated bonds rose by over 2½ percent in five weeks. This prompted the Bank of England to make facilities available to the banking system for the temporary sale and repurchase of short-dated gilt-edged stocks; under these arrangements the Bank bought 358 million pounds of stock on June 30th which was resold to the banks on July 14th. Such an innovation was adapted from regular Federal Reserve System practice in the United States

[8] Relevant to this was the sterling crisis of June 1972 which occasioned a cash shortage heavily concentrated on the clearing banks.

and introduced because it was considered to afford the market only exceptional and temporary relief. Even so, the Bank's intervention in the market cast some doubt on its readiness to permit movements in rates sufficient to allow market forces to operate.

In August 1972, the Governor of the Bank of England wrote to the banks and asked them to make credit less readily available to property companies and for financial transactions not associated with the maintenance and expansion of industry.

On October 13th, the method of setting Bank rate was changed. On this date the Bank of England announced that it was abandoning its practice of fixing the rate from time to time and that henceforth its minimum lending rate would be set each Friday at one-half of 1 percent above the average tender rate on Treasury bills, rounded to the nearest one-quarter of 1 percent above. Concerning the change, the Bank explained that with the introduction of the new arrangements for the control of credit, the significance of Bank rate as a conventional reference point for other interest rates was reduced. But the function of Bank rate as a market instrument remained, being the minimum at which the Bank would normally lend to the discount market. The increased flexibility of interest rates envisaged by the authorities, however, required a last resort lending rate which could respond flexibly to changing conditions in the money market, without movements in it being interpreted as signalling major shifts in monetary policy. From these considerations it emerges that the basic argument supporting the 'floating' Bank rate system was the contribution it would make to the more efficient functioning of the money market. The Bank also noted that a change in Bank rate independent of the new method of calculating it was not excluded if this was required to signify a shift in official policy. In such a case, the operation of the automatic formula for setting the rate would be suspended until market forces moved into line.

In November the Bank announced a call for Special Deposits from banks and finance houses observing reserve ratios, equivalent to 1 percent of their total liabilities. Another call for 2 percent was announced in December. A further call was made in July 1973, bringing the total to 4 percent of the eligible liabilities of the banks. In this connection, it should be mentioned that a central bank scheme for 'differential calls' for Special Deposits was agreed with the banks and finance houses in November 1972.[9]

In anticipation of British entry into the European Economic Community on January 1, 1973, the Bank of England announced in

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[9] For details see "Competition and Credit Control: further developments", March 1973, Quarterly Bulletin, p. 52-55.

November 1972 some important modifications of its attitude towards banking mergers and participations. Most notably, it made it clear that it would no longer object in principle to clearing banks acquiring holdings of more than 25 percent in accepting houses (i.e. merchant banks which are members of the Accepting Houses Committee) and that it would be prepared to treat other E.E.C. banks in the same way as other British banks, so that the way was open for consideration to be given to proposals for E.E.C. banks to acquire holdings exceeding 15 percent in accepting houses and other merchant banks, and in British overseas banks.[10] It is also highly significant that the Governor of the Bank of England, speaking in Scotland two months later, said that "clearing bank amalgamations south of the border have gone as far as would be permitted for as far ahead as one can see".[11]

In July 1973, technical but highly significant and important changes were made in the credit control rules applied to the discount market. As noted earlier, the members of the discount market observed a 50 percent public sector lending ratio. The ratio was now replaced by a limit of twenty times their capital and reserves on their holdings of certain assets - mainly private

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[10] For full text, see December 1972, <u>Quarterly Bulletin</u>, p. 452.

[11] Speech by the Governor of the Bank of England, given before the Institute of Bankers in Scotland on January 22, 1973.

sector debt. According to the Bank of England, the public sector lending ratio tended to complicate it's task of securing adequate influence over credit extended by the discount market, and produced distortions in short-term money markets.[12]

In August a ceiling was put on the rate of interest that can be paid on bank deposits of 10,000 pounds and under. The objective was to protect the position of the building societies and savings banks.

Such as they are, the foregoing developments suggest that a partial retreat from the spirit, if not the letter of _Competition and Credit Control_ has occurred. Let us now assess the impact of the new approach to monetary policy during its first thirty months.

The Impact of the New System

Perhaps the best way to assess the results of the changes in credit control introduced by the Bank of England in September 1971 is to note the lack of any clear and thorough statement of what the new approach to monetary management was intended to achieve and of the assumptions on which such expectations were based.[13] Official statements were ambivalent

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[12] For details, see "Competition and Credit Control: modified arrangements for the discount market", _Quarterly Bulletin_, September 1973, pp. 306-307.

[13] The following section follows Peter Marks, "Competition and Credit Control - the first eighteen months", _The Banker_, March, 1973.

about the positive merits of competition in its own right. One may infer from the basic documents that competition was intended to be advantageous in two ways: within the banking sector, and through the influence of that sector of the economy as a whole. With respect to the banks, the premise would be that the more efficient, in terms of the costs of intermediation, gain business at the expense of the less efficient, with part of the saving being passed on to depositors and borrowers in more favourable rates and charges. As regards the rest of the economy, the argument is based on the proposition that the allocation of credit - both by depositors to banks and by banks to borrowers - according to price maximizes economic welfare. Underpinning this belief is the presumption of normative economics that unfettered financial markets lead to the optimum allocation of resources, through reduced costs and the distribution of credit by the price mechanism - that is the rate of interest.

Consequently, the authorities rejected in principle those practices which restricted competition whether such practices had been imposed by themselves or whether they were the consequences of the banking sector's own behaviour. At the same time they rocognized that the competitive solution to allocation problems does not necessarily accord with social priorities. In consequence, the authorities reserved the right

(1) to reintroduce selective credit control, (2) to protect building societies and savings banks from the effects of competition, and (3) to make outright purchases of stock with more than a year to run at their discretion and initiative.

As noted earlier, a limited form of selective credit control was reintroduced in August 1972, less than one year after the new arrangements came into force; emergency help was extended to banks during the sterling crisis of 1972; an American-style Regulation Q was imposed in 1973. Thus, it would appear that the authorities never intended to operate an entirely free market. Presumably the authorities are trying to achieve an optimum compromise between two conflicting objectives - competition and credit control. Or to put the point another way, it seems that they want to move as far as possible towards freedom of financial markets, consistent with the broad aims of national economic and social policy.

Concerning the targets of the new monetary policy, the authorities' position also appears to be rather unclear. "In particular it is still uncertain whether the objective is primarily to control some aspect of the money supply (some 'monetary aggregate') by the more vigorous use of interest rates, or whether the object is primarily to produce some desired structure of interest rates through more vigorous action on the money supply."[14]

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[14]Rose, loc. cit., p. 14.

This is not the place to conduct a rigorous theoretical examination of the difference between "the money-credit expenditure"interpretation (new Keynesian) of how monetary policy influences economic activity and the "money-income"interpretation (neoquantity). However, one can state that there is a difference between these two views both in theory and in the implications for the conduct of monetary policy.

At times the U.K. authorities appear to be moving closer to accepting some definition of the money supply as a target variable; this was implied, for example, by the Governor of the Bank of England in his Jane Hodge Memorial Lecture of December 1970, when he said:

> "we have certainly given more attention than formerly to the growth of monetary aggregates in evaluating policy", .. at least as "useful indicators of monetary conditions and the impact of policy generally."

Similarly, in his Sykes Lecture in November 1971, the Chief Cashier declared that the authorities had reached the conclusion before May that "the Bank's operations in the gilt-edged market should pay more regard to their quantitative effects on the monetary aggregates and less regard to the behaviour of interest rates."

In his Munich address in May, 1971, however, the Governor said:

> "Basically what we have in mind is a system under which the allocation of credit is primarily determined by its cost---It is not expected that the mechanism of the minimum asset ratio and Special Deposits can be used to achieve some precise multiple contraction or expansion of bank assets. Rather the intention is to use our control over liquidity, which these instruments will reinforce, to influence the structure of interest rates. The resulting changes in relative rates of return will then induce shifts in the asset portfolios of both the public and the banks".

Then in October 1972, at the Lord Mayor's dinner to the bankers and merchants of the City of London the Governor said:

> "I accept, as most central bankers would, that control of the money supply is one of my principal, if not my most important, concerns and I have no wish to shirk it."

Perhaps the conclusion to be drawn from these and other statements is that the authorities believe that they should be guided by changes occurring in a number of variables including the reserve base of the banking system, domestic credit expansion (D.C.E.), the quantity of money (however defined) the use being made of the money supply and credit, as well as the level and structure of interest rates. In view of the difficulties caused by the former practice of concentrating on one objective - bank lending - an eclectic stance by the British authorities makes a lot of sense.

So much for the intentions of the authorities, let us now look at the banking sector's reaction to the new measures. But before considering this experience, it should be pointed out that no detailed statement of the attitude of the banks was made when the new approach to monetary policy was adopted in 1971, though the clearing banks issued a brief qualified welcome to the new arrangements, and their chairman subsequently made some further general comments in their annual reports. It should also be added that the new measures were deliberately introduced at a time when the U.K. economy was slack, and easy money was appropriate to the circumstances. Since then the British economy has experienced a period of growth leading to tighter monetary conditions. Thus the new arrangements have operated in various circumstances.

The lifting of official restraints on bank lending triggered off a tremendous growth of bank credit. For the first two years of banking competition the industrial loan market was a weak one. As a result, lending to the personal sector, which had borne the brunt of official policy for so long, accounted for a notable part of the increase in bank advances. More forceful advertising and new forms of lending, such as term home improvement loans, have led to an intensily competitive atmosphere between banks and finance companies for this form of business. In short, personal credit is clearly a growth area in today's commercial banking environment.

The recovery of the British economy during the closing months of 1972 produced a general revival in bank borrowing by manufacturers. In consequence the banks increased their share of industrial finance, and they also became more active in the field of medium-term lending. It may be useful to add that some earlier attempts by the clearing banks to develop medium-term lending were frustrated by successive credit squeezes.

As already indicated, lending to the financial sector, including property development companies, rose sharply until an official directive cut it back in mid-1972. On the other hand, bank loans for private house purchase remained insignificant - only about 4 percent of aggregate house loans compared with the building societies 75 percent. Clearly the banks are not prepared to take responsibility for the provision of house finance on a large scale. Also deserving of mention here is the fact that banks are trying to put more customers into fixed-term loans as opposed to overdrafts.

Sterling deposits have grown at a huge rate since 1971, and the clearing banks are now competing more vigorously for them, both among themselves and with other institutions, quoting market rates and accepting funds for periods other than seven day's notice. Some banks have introduced an insurance linked scheme for attracting personal savings. Others are emphasing the vast range of personal financial services they offer, by clever advertising, by new marketing approaches, and the like. Not surprisingly, there has been a move from non-interest bearing current accounts to deposit accounts in all banks.

Competition has brought much better 'packaging' of services offered by banks. Each bank now has marketing departments to ascertain the needs of customers, and to see what can be done to meet them. As noted earlier, the volume of medium-and long-term lending has increased. All the major banks now issue credit cards, and are moving rapidly into factoring, equipment leasing, mutual funds, insurance, portfolio management, estate planning, and international services (either through direct representation or through consortia). Barclays Bank Ltd., for example, claims that it offers over 150 separate financial services. This trend towards 'one-stop' banking is becoming increasingly attractive to the majority of personal and corporate customers of the new credit age, especially since banks have started to use their computers as tools more sophisticated than adding machines. In other words, banks are now adapting their financial services to fill the gaps shown by their own computer studies. This has resulted in a range of banking activity that was not even dreamed of three years ago.

One of the most important consequences of the new system of credit control has been the enormous growth in the inter-bank and certificate of deposit markets. The interbank market was of course no new development and had been - and still is - of vital importance to the foreign and overseas banks, as it gives them the opportunity to raise wholesale sterling deposits and thus overcome the disadvantage of having no widespread branching system. But it had been denied to the clearing banks, who could quote only for funds on seven-day deposit and at an agreed rate. Over recent years, clearing banks have increasingly entered this market, not only to raise their marginal requirements for funds but also to balance their day-to-day positions and to maintain their liquidity. This means that the clearing banks now have the kind of manoeuvrability which the so-called 'secondary' banks have long enjoyed. Such manoeuvring is termed 'liability management'.

In this connection, it should be added that clearing banks with subsidiary companies generally offer term money to their affiliates if such firms are prepared to pay a higher rate of interest for deposits than they are. This is designed to insure that investors obtain the highest prices for their loanable funds.

Mention of clearing bank groups raises the question of whether future developments will take place through the clearing bank parents or their subsidiaries and whether subsidiaries will continue to engage in their existing activities.[15] As a pointer to possible trends, amicable divorces have already occurred between some of the banks and finance houses. Also, some groups have fully integrated the business of deposit-taking subsidiaries with that of the parents. In addition, the early growth of merchant bank activities on the part of the clearers has appeared. Such as they are, these developments suggest a move towards the conglomerate form of banking organization.

Before leaving this matter, it should be pointed out that several British banks have merged since 1971. These include the amalgamation of Barclays DCO (for Dominion, Colonial, and Overseas) with Barclays Bank Ltd.; Standard Bank and Chartered Bank; and Lloyds Bank Ltd. and the Bank of London and South America and Lloyds Bank Europe. These moves were made against the background of a rapidly developing international scene, and were intended to give the banks concerned a more dynamic international banking capability. Most of the major British banks also have interests in one or more multinational or consortium banks.

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[15] It may be worth recalling that the clearing banks are owners or substantial part owners of most of the major finance houses and merchant banks. Also some do their factoring, equipment leasing, property development, mutual funds, etc. through subsidiaries.

Three observations are worth stressing here. First, some earlier attempts by the banks to expand overseas lending were frustrated by direct quantitative control. Now the banks are free to enlarge their opportunities in the international markets for financial services. Since international markets are likely to receive far greater attention in the future, further structural changes are to be expected. Second, it is clear that the Bank of England is in favour of this type of reform. This is reflected in its new attitude towards banking mergers and participations, the details of which were announced late in 1972. Third, the logic of the new credit environment in the U.K. is pointing firmly towards the concentration of financial business in a smaller number of larger multi-purpose and multinational financial institutions. Whether the management of such institutions and the management of industry should be kept separate or be integrated is another matter and is better discussed in a German context.

Other important developments arising out of the revamped monetary controls include the following:

1. Although the new system of credit control did make a distinction between finance houses and other banks by conceding a lower reserve ratio for the former, six of the major installment credit finance companies decided to pay this 'price', and registered as banks. They felt that the extra burden of having to meet the full reserve

requirements of a bank would be more than offset by the advantages the change of status would bring in enabling them to develop their business more broadly (e.g. foreign exchange transactions, issuing sterling CDs).

2. Since the First National City Bank of New York through its subsidiary, the National City Trust Limited, opened the first so-called 'money shop' in London in mid-1969, there has been a spate of companies emulating its example and more are likely to follow. In general terms, money shops are retail outlets in 'high' streets, shopping centres and stores, offering a variety of banking services.[16] They differ from the clearing banks:

   (a) in the range of services offered, which for the most part is much narrower;

   (b) in the design and decor of the buildings, which a recent survey (published by the U.K. Opinion Research Centre) claims is more "pleasant", "eye-catching", "modern", "bright" and "welcoming";

   (c) in the hours of business, which are longer and more convenient (Saturday openings); and

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[16] For a good analysis of this new phenomenon see D.G. Hanson, "Money Shops or Not?", Journal of the Institute of Bankers, April, 1973, pp. 71-82.

(d) in the presentation of their services to the public, which in the main is more friendly and less formal.

The services offered by money shops include:

current accounts
fixed deposit accounts
personal loans
bridging loans
second mortgage loans
insurance services
cash facilities.

At the present time there are believed to be up to 80 money shops in the U.K. What is more, there seems to be plans in hand for at least as many again in 1974. There is also talk of other organizations - finance houses and insurance companies among them - entering the money shop business. The main point is this: the money shops have made important inroads on traditional bank territory. They have added a new element of competition into the market for personal financial services, and seem likely to move into venture capital financing.

3. Some merchant banks have recently merged, and most have expanded into insurance broking, commodity broking, and are dealing directly in securities, thus by-passing the

Stock Exchange. They are also meeting increasing competition in the market for deposits and some have predicted a contraction in their over-all business as a result of such competition with the banks and other deposit institutions. As might be expected, the merchant bankers believe that they can still live and thrive on their flexibility, expertise, and ability to respond quickly to the needs of their clients.

4. Insurance, too, is becoming more and more closely linked with other financial activities; with clearing banks, which have their own insurance broking subsidiaries or their own insurance - linked savings schemes; with house purchase finance; with the finance houses; with commodity broking; and with property finance. In addition, several insurance companies are substantial part-owners of finance houses, and one insurance company, the Norwich Union, has recently established a wholly-owned subsidiary which carries on a banking business. As the Inter-Bank Research Organization's report on "the future of London as an international financial centre" has has observed: "For the future, it would be unrealistic to rule out the possibility of full-scale mergers between insurance companies and other financial institutions".[17] Then indeed, we would have a financial supermarket.

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[17] Her Majesty's Stationery Office, June 1973, p.1-30.

The inference to be drawn from these developments is clear: the traditional distinctions between deposit banks, finance houses, merchant banks, insurance companies, savings banks, discount houses, foreign banks and other financial institutions, are becoming blurred and largely inappropriate. Structural changes of the kind mentioned above are continuing and will accelerate as Britain devélops closer economic and monetary ties with the other nations of the European Community.

Foreign Banks

Commercial banks in the U.K. are subdivided into four main groups: clearing banks, merchant banks, overseas banks (British and foreign) and other banks (these are largely subsidiaries of clearers). The clearing banks (on the basis of their sterling deposit liabilities) are four times larger than any other banking group. Second comes overseas banks, mainly the U.S. banks in London. The third largest group are 'other' banks whose resources are now larger than those of the merchant banks.

Foreign banks fall into two well-defined classes. A number of them are banking concerns in the fullest sense and attempt to compete with the domestic commercial banks for sterling business. Actually only the U.S. banks in London are presently able to offer true competition to the massive resources controlled by the clearers. The second category of banks mainly operate in the wholesale markets and are largely oriented towards international finance. This is the case, for example, with the five Canadian banks operating in London. It should be stressed, however, that there has always been strong competition between the domestic and foreign banks for non-sterling borrowing and lending.

Until the change in credit controls, foreign banks had largely been prevented from building up a sterling business by their lending limits. For example, an American bank coming to London in the 1960's might be given a sterling lending ceiling of 1 million pounds or so, and fill it in an hour.[18] The fact that lending was limited, resulted in comparable curtailment of borrowing. Since the new credit policy was introduced, the net sterling deposits of the American banks have virtually doubled, bringing their share of the total from about 4 percent to 6 percent. And lending by the U.S. banks is now about 10 percent of sterling advances by the clearing banks.

Thus U.S. banks in England are now competing vigorously with the clearing banks for sterling business (both deposit and lending), courting both companies and the British consumer.

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[18] Controls on sterling lending were first introduced in 1964. Thus, in general, if a bank started with a low ceiling on their sterling advances, it stayed that way, except for minor increases, after 1964. Canadian banks were less restricted than most American banks after 1964, because of their relatively earlier arrival in Britain.

No fewer than 40 U.S. banks now have branches or offices in London. Bank of America now has a branch in Edinburgh and is thinking of opening one in Aberdeen, headquarters of the North Sea Oil boom. First National City Bank, in addition to its vast banking operations in England, is snatching further business from the clearers with its aggressive 'money shop' services.

Except for Citibank, the foreign banks lack the branch network and interest-free deposit base of the clearing banks. A large French bank, the Credit Lyonnais, has a small branch system in the U.K. as does the Bank of Nova Scotia (as might be expected, it is mainly in Scotland). The most adventurous of the foreign banks (read mainly American banks), however, have gone far towards compensating for this deficiency by providing a different type of domestic service from that which a clearer would offer. In consequence, they are able to offer the clearers substantial competition.

In general, it would appear that the foreign banks in Britain have not used their new freedom to move towards retail banking. Conversely, they have taken all possible advantage of the new opportunities to build up their wholesale and international business. Given the enormous growth in the number of foreign banks in the U.K. in recent years, it is clear that there is a good deal more competition for this type of business than there use to be.

There are now some 170 different foreign banks transacting banking business in the United Kingdom. This is far more than any other financial centre. Within this context, it may be worth recalling that the Bank of England announced in November 1972, that the way was now open for consideration to be given to proposals for E.E.C. banks to acquire holdings exceeding 15 percent in merchant banks, and in British overseas banks. It also declared in the same statement that:

> "The liberal practice in relation to the establishment of branches or subsidiaries in London by banks from other foreign countries will continue, and the Bank's attitude to participations by these banks in British banks remains unchanged".

Concerning the Bank's new attitude to banking mergers and participations, the Governor said:

> "..it seemed to us that the British banking industry might see advantage in some changes in structure in order the more effectively to compete in the wider market for banking services

> now opening up. We were concerned, therefore, ...to ensure that obstacles to change were not unnecessarily retained."[19]

One inference to be drawn from this comment is: in a dynamic, growing, complex economic community, banks must be free to respond to financial needs as they occur. Since these needs cannot be predicted very far in advance and they alter materially over periods of time, to place banks in a conventional or statutory straitjacket would be an action decidely against the public interest.

Consortium Banks

Historically, the consortium banking movement dates from 1964 with the foundation of a bank called Midland and International Banks Ltd., now universally referred to as "Maibl". Maibl's parents are the Standard Bank, Commercial Bank of Australia, and the Toronto-Dominion Bank. Since then, all the major U.K. deposit banks, except Lloyds Bank,[20] and more than three quarters of the world's 50 largest banks (in terms of deposits) are now shareholders in at least one syndicate.

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[19] Bank of England, Quarterly Bulletin, March, 1973, p. 57.

[20] Like the First National City Bank of New York, Lloyds Bank has not joined in any consortiums. Put another way, Lloyds, like Citibank, prefers to go it alone in the international field. These banks do not like minority participations in such consortiums; They prefer to control their overseas operations by themselves. Significantly, Citibank now obtains 50 percent of its profits from overseas transactions.

In general, the shareholders of most consortium banks are themselves banks (but several participants are nonbanks - e.g. an insurance company), are of different nationality (one consortia includes banks based in eight nations), and come mostly from the developed countries of the North Atlantic.

A majority of consortium banks are based in London. The other great domicile for recently formed banking consortia is Australia. This is partly explained by the fact that, since 1942, Australia has banned the establishment of branches of foreign banks within its borders. Other locals for consortium banks are Brussels, Luxembourg, Zurich, Milan and Paris.

According to one British banker there are four main reasons for the rapid rise in size and importance of consortium banks:[21]

1. "the growing financial requirements of industry which, in a time of rapid technological development, have outrun conventional banking sources of satisfaction;
2. the development of the multinational corporation;
3. the rapid growth of the Euro-dollar market, in many ways the nearest approach we have yet seen to an international capital market;

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21 R.G. Dyson "New Patterns in British Banking Overseas", Presidential Address to the Institute of Bankers, May 16, 1973, p. 2.

4. in a narrower European context, the prospect of an integrated economic and political unit coming into being which will embrace most of Western Europe and in GNP surpass even the United States."

By and large, consortia specialize in the provision of medium-term finance, in sterling and foreign currencies, to large corporate borrowers. They are also important takers of short and medium-term deposits in sterling and other currencies. In addition, many consortia serve a variety of purposes that relate to the strategy of shareholders. For example, a U.S. bank may be lending a client as much as a local banking law allows, or the client may be an international corporation with complex borrowing requirements in foreign markets. The non-controlled, foreign domiciled consortium being independent of U.S. legal requirements, provides an effective solution to both these problems. In addition, local competition may be kept out of a clients borrowing with the help of a consortium.

Much of a consortium's business comes from other consortia, particularly on the asset side of its ledger. Syndication is the rule in the Eurocurrency lending business,[22]

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[22] A consortium bank will take the lead in negotiating a loan and then bring in other lenders to participate in the issue; the number of lenders has ranged from three to 50 spread throughout the world. Each member of the syndicate agreed to provide a certain portion of the total amount, although the lead bank need not contribute.

and a typical loan is quite sizable in relation to both the consortium's capital accounts and its deposit capacity.[23]

In discussing consortium banks it should be remembered that all the leading clearing banks have established an 'international division', which handles the bank's overseas business. As just mentioned, most of these banks also have interests in one or more consortium banks. And therein lies the rub. Does this mean that a bank's 'international arm' must compete for business with its affiliated consortium, as well as with the international banking divisions of other banks? In some activities, the answer to that question is in the affirmative. In the main, however, the relationship between a bank's overseas department and its associated consortium is complimentary. For example, a customer might want a bank loan denominated in German marks. This can easily be extended by the U.K. bank, if it negotiated on a term loan basis. However, if the customer wanted over-draft facilities (i.e., a chequing account), the U.K. bank would find it more convenient to turn this business over to its consortium and have the Germany partner make the loan in Germany. Also, as implied above, a consortium allows certain kinds of risk to be spread over a larger number of participants, thereby reducing the risk for each one of the partners. In addition

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[23] The average size of a syndicated loan is about $100 million. The largest one so far issued was the $300 million raised in April 1970, by ENEL, the Italian state electricity organization for seven years.

a bank might not be familiar with the background and needs of a particular customer - say the Gabon. In this case, the British bank would refer the Gabon to its consortium and ask its French partner (assuming it had one) to take the lead in arranging such a loan. Again, a consortium, with its difused nationality, could be employed to make loans in certain sensitive areas, such as Spain, Greece, or Rhodesia - loans which an individual British bank might be unwilling to undertake, particularly, if knowledge of them became public.

To sum up, the propelling forces behind the current consortium banking movement, cited earlier, are far too strong to be reversed. The consortium is the only way to link the power of several national financial markets, and it has the further advantage of being a less obvious target for chauvinism. Moreover, the international market(eurocurrency and eurobond markets) is significant, must be served, and presents opportunities for profits. On the other hand, the competition among consortium banks has resulted in margins being cut to the point where some bankers wonder if any profit can be made. Another widespread criticism is that lending standards are being lowered (loans are being made to borrowers, some of whom would not have obtained funds at any price only a few years ago); investigation of a borrower's worth, it is argued, should be tightened up . Since the funds used by consortiums are largely obtained in the Eurodollar market, more national, or even supranational, control of the Eurocurrency market could create serious problems for both lenders and borrowers. These fears suggest that there may be some shaking out in the consortium movement before too long. In other words, it is conceivable that some mergers between consortium banks may soon be undertaken. Indeed, it is increasingly recognized that a fair amount of rationalization would be a good thing.

Conclusions

Clearly, judging the effects of the new policy on the banks and the economy is a complicated problem which is largely beyond the scope of this brief survey. Nevertheless, several observations are worth stressing here.

As regards the banks, the operating margins between deposit rates and base rates have been reduced. Though this fact is subject to several qualifications and interpretations,[24] it may well be regarded as evidence that the banks have improved their efficiency. The new arrangements have stimulated the latent talent for new initiatives and reinforced the profit-maximizing motive. In consequence, the banks have rearranged and improved the services they offer; they have provided a wider range of both lending and deposit facilities.

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[24] For a more detailed discussion on profit margins, see P. Marks, "Competition and Credit Control", The Banker, March 1973.

It is therefore reasonable to assume that "this provision of better financial services should materially contribute to the greater efficiency of British industry".[25] However, this beneficial result is not self-evident as yet. What is more obvious is that the banks have taken advantage of their freedom to lend and have entered the consumer market in a bigger and more organized fashion. This added a desirable new element of competition into the consumer credit market. Since credit makes it possible for individuals to spread their consumption over time, one may postulate that increased bank participation in direct consumer lending means a higher level of overall economic welfare.

Since the new arrangements,

> "the trend has moved a long way further towards a single market, not just for credit but for other financial services too. As customers have become more conscious of the need to manage their finances as a whole, the market has become more like a single market for cash flow management and advisory services; new types of financial activity have emerged to fill gaps in this market, thus integrating it even more closely, and the differences between the activities of the various institutions are not nearly so clear-cut as they were."[26]

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[25] Bank of England, Quarterly Bulletin, December 1972, p.515.

[26] Inter-Bank Research Organization Report (IBRO), loc. cit., p. 1-28.

To some, the aforementioned development holds promise of greatly improved efficiency in meeting modern demands for financial services. To others, it raises the spectre of an economy dominated by huge multi-national conglomerate financial organizations. We need not here go into this complex issue. It suffices to note that the IBRO report accepted the trend towards the giant universal bank as irreversible and beneficial and it waxed enthusiastic about "accepting certain features of the German and French/Italian financial systems". At the same time it stressed the advantages of a market-orientated financial system. The intention is to meet the economic and financial needs of modern society within the framework of competitive, open, market-oriented capitalism, and get the best of both worlds. But so far, the authorities have not actually endorsed the structural changes recommended in the IBRO report. Perhaps this is because "the authorities are much less sure of themselves about the general lines of the new policy of competition and credit control."[27]

It is difficult to judge what effect the widening of the spread of lending rates, and the distribution of credit according to price, has had upon the British economy. There can be no doubt that interest rates have risen substantially in recent years, but it is certainly not clear that there has

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[27] Hugh Stephenson, "Unrealities of a City Blueprint", The Times, London, June 6, 1973.

been more selective lending. Some will argue that interest rates have not reflected the time-preference of the community - the relative importance which society attaches to future as against present satisfactions - because the Bank of England, for political reasons, held down the nominal rate of interest too long.[28] Others contend that it is the reimposition of qualitative control on the banking system which is to blame. At any rate, it cannot be taken for granted that because interest rates are now much higher than they would have been under the old arrangements, that this is necessarily beneficial to the economy as a whole; it may be, but it is not self-evident.

A full judgement of the new arrangements would have to include a measured assessment of the effectiveness of credit control during its first 30 months, a task which is largely beyond the scope of this survey. Nevertheless, a few comments are worth making here. One U.K. authority, Prof. R.G. Opie of Oxford, has concluded, that the first year's experience of the new credit policy was a "total shambles".[29] And even the Bank of England concluded that its record on credit control in 1972 "was somewhat disappointing." When the

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[28] For example, when nominal interest rates began to rise rapidly in 1972, the Bank of England attempted to moderate this rise through open-market purchases of gilt-edged securities from the clearers and through the provision of a 15 million pound interest rate subsidy to the building societies.

[29] R.G. Opie, "The new lady of Threadneedle Street : an outsiders view", Competition and Credit Control: One year on, Gillet Brothers, December 1972, p. 26.

situation did not improve in the first half of 1973, the Bank, in September, added personal lending to the restricted categories, and asked the banks to pay no more than 9½ percent on any interest-earning balances of less than 10,000 pounds of whatever term to maturity. Then on November 13, the Bank raised its minimum lending rate (MLR) from 11¼ percent to the 13 percent level, and levied special deposits to the tune of another two percent, amounting altogether to 6 percent.

According to some economists, the major weakness of the new credit system is the fact that the reserve asset system is complicated and made untidy both by the wide variety of assets that qualify as reserves and by the divergence of qualification for eligibility as between different types of institutions. Thus, in practice, there is abundant scope for credit creation in transfers of assets as between banks and non-banks in the private sector.[30] Under these circumstances, some critics have suggested that the minimum reserve asset ratio be replaced by a cash reserve ratio, which can be quickly and precisely adjusted by open-market operations in the gilt-edged market.

Another alleged defect of credit control is that movements in the Bank of England's minimum lending rate are

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[30] For a detailed exposition of this argument, see David Lomax, "Reserve Assets and Competition and Credit Control", National Westminster Bank, Quarterly Review, August 1973, pp. 36-46.

anamalous, because of the special factors that determine its level.[31] Accordingly some commentators contend that the MLR procedure should be abandoned. Their choice of a substitute official discount rate lies between "a discretionary rate - though presumably one free from the undesirable phychological and political connotations of Bank rate (as one of them puts it, 'to avoid a national sense of crisis every time a Bank rate raise is announced on television on the 9 o'clock news') - and a rate determined by a wider spread of market rates."[32]

All the same, no unexpected constraints on monetary policy have emerged as a result of the introduction of the new arrangements for credit control. Certainly nothing has happened so far to imply that it will be necessary to abandon the new system with the undoubted stimulus it has given to competitive and efficient banking and finance.

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[31] In general, the Bank's official lending rate is determined by the amount that discount houses are prepared to pay for their weekly allotment of Treasury bills. The supply of bills is a function of the Government's immediate borrowing requirements. Demand is determined not only by the limited attractions of bills as investments but also by the overall state of the discount houses books (i.e., the structure of their assets and liabilities). And therein lies the problem. Heavy bidding for bills can keep the rate below the level at which an increase in minimum lending rate would be indicated. Conversely, heavy selling can keep it above the indicated level. In a word, changes in MLR can be perverse.

[32] Ian Morison, "Learning to Live with Market Forces", The Times, London, June 7, 1973.

Relevant British Financial Institutions

In this section of the survey I examine the functions of several of Britain's important financial institutions to see which of their activities could conceivably be fitted into the Canadian banking milieu. Since agriculture is still one of Canada's basic industries, let us begin with the Agricultural Mortgage Corporation Ltd.

AMC

The primary function of this Corporation, which was established in accordance with the Agricultural Credits Act 1928 and 1932, is to grant long-term loans of up to 60 years against first mortgages on agricultural lands and buildings in England and Wales, although at present the average term is 24 years. The share capital is subscribed by the Bank of England and the London clearing banks, but the much greater part of the funds is derived from public issues of debentures of which about 180 million pounds is outstanding. The debentures are backed in part by a guarantee fund provided by advances from the Government.[33] The existence of this fund enables AMC to raise its debentures in the gilt-edged market on terms more favourable than those available to commercial or industrial companies. In addition, the

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[33] The Agricultural Credit Act empowers the Minister of Agriculture to advance money to AMC, interest free for 60 years. These advances (currently about 12 million pounds) have to be invested in gilt-edged securities to form the basis of a guarantee fund to provide proportional backing for issues of AMC's own debentures.

income derived from the guarantee fund is passed on to AMC's borrowers in the lending rate in line with AMC's mandate to lend on "most favourable terms".

Up to the year ended March 31, 1972, the total of AMC loans granted since inception was 268 million pounds (of which 170 million were granted in the past 8 years) on almost 4.3 million acres. Loans outstanding at that date totalled 179 million pounds to 11,000 farmers secured on 2.3 million acres, which is 8½ percent of the agricultural land in England and Wales.

Loans currently being granted at the rate of 20 million pounds per annum are available for any reasonable purpose: 60 percent of the lending in any year is for the purchase of land, 30 percent for the repayment of other loans (mostly taken originally for purchase), and the remaining 10 percent for improvements or working capital, etc. Some loans are not first mortgages and do not require deposit of the title deeds.

Also deserving of mention is the fact that AMC has recently tapped two new sources of finance, short-term term bonds and medium-term bank loans. To date, AMC has issued 6½ million pounds of short-term bonds and negotiated one term loan in the amount of 10 million pounds for a period of 10 years. In consequence, AMC is now in a good position to offer its customers two types of loans - either a conventional term loan, in which both the repayment period and rate of interest is fixed, or a variable term loan in which the interest rate is variable over the fixed period of the loan. In the variable case, interest rates are reviewed each six months and either raised or lowered according to the current cost to AMC of the funds from which such loans are made. About one-third of AMC lending to farmers is now on a variable-rate basis.

Another important point is this: the new framework for banking practice and monetary policy appears to have had two contrary effects on farm credit. On the one hand the operation of the new policy has helped to expand AMC's activities in the farm credit field; on the other it seems also to have reinforced the tendency for the banks to reduce their activities in this field. As noted earlier, interest rates in the U.K. have risen particularly sharply since the middle of 1972. It should also be pointed out that bank loans to farmers are made almost exclusively on an over-draft basis and that a good part of these loans are hard core - that is to say, they cannot be paid out of current income. Thus, although the value of farm properties has been increasing apace with other property values, it appears that bankers believe that farmers have less ability to pay the current price for credit than other business borrowers. Accordingly, bankers are attempting to shift most of their farm business, especially that element which is essentially long term, over to AMC. Any economist can argue that this is beneficial to the economy. For what it is worth, farmers, who are net lenders to the banks, may take some convincing.

One general remark should be made in concluding this section. In Canada, the chartered banks are by far the most important source of short-term and intermediate-term credit for farmers. Long-term credit is generally obtained by Canadian farmers from a host of government lending schemes. As Canadian farms become larger in size and fewer in number, there will be a growing need for large amounts of long-term credit. Given the probable changes ahead in agriculture, it is certainly arguable that a more rational basis for extending long-term farm credit in Canada might be through a single, bank-based organization like AMC.

ICFC

Another institution which has some relevance to the Canadian scene is the Industrial and Commercial Finance Corporation Ltd. (ICFC). It was established in 1945 by the Bank of England, the London clearing banks and the Scottish banks to provide medium and long-term capital for small and medium sized business.

Originally the shareholding banks provided all the funds for ICFC partly by way of share capital and partly by loans and overdrafts. Since 1959 the shareholders have provided only equity capital, the last issue being in 1966 (ICFC's present issued capital is 40 million pounds), and all additional needs have been met by recourse to the money and capital markets by means of debenture stocks, unsecured loan stocks and term deposits.

ICFC has not appeared to restrict its financing to any specific geographic area or any particular industry but has made funds available to what it considers to be creditworthy enterprises in all sectors of the country and in all fields of economic activity.

Loans generally range from 5,000 pounds to a maximum of 300,000 pounds, except that an already financed customer can sometimes obtain as much as 500,000 pounds in total loans. The average size of a loan is about 40,000 pounds.

Although ICFC does authorize demand loans to already existing customers, it is primarily a supplier of long-term capital: approximately 80 percent of ICFC loans have a final maturity running from 10 to 20 years; the average term is about 15 years.

Equity investment by ICFC is far less important in total value than its loan financing. And it seems that ICFC has seldom been interested in obtaining more than a minority equity interest in the companies which it finances.

Non-financial services of various kinds specifically designed to cater for the special problems of small companies are also provided by ICFC on a fee basis. These include consulting services in the fields of marketing, public relations and advertising, recruitment, production and accountancy, computer bureau services and management and staff training services.[34]

ICFC's profit record, "based on a policy of seeking long-term growth in preference to short-term profits", is well established on a steady upward trend, as shown below for the past 5 years:-

Year	Profit Before Tax	Tax Charged	Gross Dividend	Retained Profit
		000 pounds		
1968	4,303	675	2,400	1,050
1969	4,507	821	2,600	912
1970	4,994	971	2,800	1,171
1971	4,699	713	3,000	1,002
1972	5,842	1,203	3,200	1,357

[34]For a good analysis of ICFC operations for the years 1968, 1969 and 1970, see R.C. Osborn, ICFC Financing small and medium sized businesses, published by ICFC in January 1972.

Prior to 1971, most ICFC business resulted from bank referrals. Since then, the banks have increased their term lending to industrial and commercial enterprises. In consequence, ICFC must now look more to its own future. And it should be noted that it does so with equanimity. To use ICFC's own words:

> "The Corporation has always faced some competition from specialist subsidiaries of the shareholding banks, their associated companies, the merchant banks, insurance companies and other institutions .. we have withstood this competition by offering a better service and a more varied range of facilities, and we think the present competition in our market will give us a better chance to prove our ability in our chosen field. Our competitors, whatever the resources they commit to the market, have not yet acquired the experience of handling difficult minority situations which we have built up over the years. We have a considerable lead and although some of the new institutions may emerge as a powerful influence, we are confident that we have the inherent strength both in management, staff and portfolio, to enable us to maintain our market leadership.

...Our policy of seeking long-term growth enables us to identify our own interest with that of the customer and allows us to remain 'locked in' to situations indefinitely - an attitude which our competitors find difficult to emulate.

...One of our major strengths is our ability as an organization to be flexible and to react to a changing environment. We think that this ability, together with our strong underlying position, enables us to look to the future with confidence".[35]

Admittedly, the banks are going to increase their own in-house activities with respect to term credits for small/medium sized firms, but the banks, which own ICFC, still regard the Corporation as a good investment, and also as the proper vehicle for doing certain types of things - things which the banks still regard as inappropriate for themselves. For these reasons, I tend to agree with ICFC's assessment of its own future - it does appear bright.

One final point: in terms of functions, activities and modus operandi, ICFC resembles the Industrial Development Bank of Canada. On the other hand, ICFC is a private

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[35]Abstracted from an ICFC memo for internal circulation only.

enterprise institution (the Bank of England's participation represents only 3.33 percent of total equity), whereas the IDB is a wholly owned subsidiary of the Bank of Canada. Also ICFC is a commercial organization dedicated to achieving an acceptable return for its shareholders whereas "the IDB has a strong socio-economic role, shading far into the realm of government assistance to underprivileged sectors of the economy".[36] In addition, ICFC's loans are made available to business at market rates whereas IDB loans are 'subsidized' due to 'cheap' borrowings, freedom from income tax, and the lack of underwriting and legal costs associated with the raising of money by public bond issues in the capital market. In the light of these differences and in view of the Government's proposal to transform the IDB into a Crown corporation under the Department of Industry Trade and Commerce[37], some thought should be given to the establishment of a privately owned development company, like ICFC.

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[36] Philip Mathias "Do we really need the IDB any more?" The Financial Post , November 18, 1972, p.C-1.

[37] This proposal was announced by Mr. Gillespie on January 16, 1974.

ADDENDUM: UNITED KINGDOM

Since mid-1973, some significant developments have occurred on the U.K. monetary and banking scene. In the course of 1973, the United Kingdom experienced an unprecedented rate of monetary expansion and bank lending, and interest rates reached historically high levels. Unwilling to reintroduce quantitative lending controls or to curb deposit growth by aggressive selling of gilt-edged securities, the Bank of England introduced "a supplementary deposit scheme" in December 1973. This control was applied only to the interest-bearing eligible liabilities (IBELS) against which the reserve assets ratio and Special Deposits are calculated - not to the non-interest-bearing elements (NIBELS). For the period ending June 30, 1974 the permitted rate of growth of IBELS was restricted to 8 percent above the level in the fourth quarter of 1973, and banks and finance houses were liable to make supplementary special deposits with the Bank, bearing no interest, at a progressive rate on any excess. The scheme was continued to the end of 1974 with the permitted rate of growth being 1½ percent per month of the amount of the base period. It was extended for a further six months months, to mid-1975, at the same maximum rate of growth, but was withdrawn in March 1975.

Over 1974 as a whole, the supplementary deposit insurance scheme imposed a fairly tight control on most banks, and a few of the smaller ones exceeded the limit and had to place some supplementary special deposits with the Bank of England. In the early months of 1975, the scheme was virtually ineffective, since the banks collectively remained well within the penalty-free limit. However, in announcing the removal of the control in 1975, the Bank of England seemed anxious to stress that the scheme was a permanent one which could be re-introduced at any time, and said that "If the scheme is re-activated the base date to which limits will relate may be before the date of announcement". Presumably this remark was intended to prevent individual banks from making a 'dash for freedom' by increasing their IBELs as fast as possible in case the scheme was re-introduced.

The request made to the banks by the authorities in September 1973 not to pay more than 9½ percent interest on deposits of under £10,000 was also removed early in 1975. It will be recalled that the purpose of this proposal was to protect building societies from competition for deposits. In January 1975, most of the banks reduced their 7-day deposit rate to 9 percent, so it was feasible to withdraw this constraint. However, qualitative guidance remained in force. The banks and finance houses were asked to give favoured treatment to export finance, import substitution projects, domestic industrial investment, and to make less credit available to persons (other than for house purchase), for purely financial transactions and to property companies. Moreover, these requests were restated in December 1975, when there was some relaxation in the terms of the control of hire purchase (in December 1973, consumer credit terms, namely downpayment and repayment period, were once more made subject to direct government control, as they had frequently been prior to 1971). At this time, the banks were told by the Bank of England that they could adopt the new terms when lending for the purchase of goods affected by the changes, but were still to refrain from providing credit on terms easier than those permitted for hire purchase contracts, and also to maintain their existing restraints on personal, financial and property loans.

At the end of 1973 the secondary banking sector got into difficulties, and two of the so-called 'fringe' banks - London and Country Securities and Cedar Holdings collapsed. This shook the British financial system and prompted a salvage operation by the Bank of England, the major clearing banks and other institutions (e.g. The Crown Agents). According to The Economist, this rescue operation prevented "a terrifying collapse of confidence in the U.K. banking system".

Early in 1974 several more fringe banks required assistance and several others were forced into liquidation (e.g. London and Country Securities and Cornhill Consolidated).

It is estimated that the clearing banks committed about £700 million to these rescue operations, or about 20 percent of their joint capital reserves.

In these instances, problems appear to have arisen from two main sources: the slump in share and property prices, which reduced the market value of long-term investments; and the thinness of the interbank market which prevented several banks from renewing their short-term borrowings.

As a result of the problems of secondary banks, the Bank of England has established in conjunction with the clearing banks machinery whereby the liquidity of fringe banks is kept under continuous review, "and in cases where additional support is shown to be necessary and justified, arrangements for reinforcing the liquidity of the deposit-taking companies concerned will be made in order to protect depositors". In this context it should be added that the Bank of England has expanded its examination of the affairs of all categories of banks and has been holding discussions with the London and Scottish clearing banks concerning the desirability of 'prudential ratios' to be observed by both the clearers and non-clearers. It is hoped to develop "broad numerical standards" over a period of time.

Banking statistics were revised in mid-1975; the three principal banking groups are now designated as the U.K., overseas, and consortium banks, with each of the first two being appropriately sub-divided.

A new scheme for medium-term finance was introduced in October 1973, when the Finance for Industry (FFI) Company was formed to bring together the Industrial and Commercial Finance Corporation and the Finance Corporation for Industry. Its shareholders are the clearing banks and the Bank of England. Its purpose is to finance productive investment, mainly in the form of medium-term loans at variable or fixed rates of interest, subject to strict criteria of commercial viability.

While FFI was established to relieve the banks of the prospect of having to provide medium term loans themselves out of short-term deposits, it is a fact that such finance by the clearers almost doubled in 1974-75. While FFI does some 50 percent of its lending at fixed rates, nearly all of the clearers medium-term lending is at variable rates. It is also worth noting here that if prudential ratios are to be applied to banks, the authorities will consider making medium term loans by the clearers eligible for refinance at the Bank of England.

In May 1976 the Equity Bank was set up to provide funds for small to medium sized companies that can't raise money through normal channels. The pension funds have agreed to subscribe £10 million through Equity Capital Unit Trust, set up to look after their tax positions. Other institutions will subscribe £20 million through Equity Capital for Industry Ltd. The trust and equity companies will act as one bank, under a board of 12 directors composed of nine nominees from financial institutions and three prominent industrialists. The secretary of the new bank was drawn from the Bank of England's staff.

A final point should be made. Despite the problems that have arisen in connection with the new control system and the departures from market-oriented control mechanisms, the U.K. banking system has maintained the main structural benefits of the 1971 reforms.

WESTERN GERMANY

Much has been written and said about the post-war economic performance of the Federal Republic of Germany. Unquestionably numerous factors have contributed to Germany's impressive record of high employment, economic growth, price stability, and balance-of-payments surplus. Among those factors that appear to be significant is the very liberal financial structure. But before considering this premise, it is convenient to describe the present financial system.

Institutional Framework

A unique and significant feature of the German financial system is the wide variety of institutions treated as banks for purposes of regulation by the central bank - the Deutsche Bundesbank - and the Federal Banking Supervisory Office. At the end of June, 1972, there were 7,842 credit institutions operating in the federal area (including West Berlin). Of these, however, about 4,300 were small or very small banks with individual total assets of under DM5 million. At the same date there were nearly 34,000 branches spread throughout the federal area, thus providing an average of one banking office for each 1500 people in Germany.

As can be seen from the table on the next page, commercial banks are subdivided into three main groups. The first contains the private commercial banks; less than one-tenth the total number of banks rendering monthly returns to the

An Index of German Credit Institutions
as at June 30, 1972

Banking Groups	Total Number of Credit Institutions	Credit Institutions Reporting to Deutsche Bundesbank		
		Number	Total Assets	Capital & Reserves
			Millions of D.M.	
A. Commercial Banks...	7,468	3,209	723,475	26,566
I. Private Commercial Banks of which	313	313	238,515	10,951
1. Big banks	6	6	98,430	4,438
2. Regional & other commercial banks	146	146	117,603	5,126
of which foreign banks	30	30	-	-
3. Private bankers	161	161	22,482	1,387
II. Public-Law Credit Institutions of which	795	795	373,716	11,079
4. Savings banks	783	783	221,715	7,724
5. Central Giro Institutions	12	12	152,001	3,355
III. Cooperative Credit Institutions of which	6,360	2,101	111,244	4,556
6. Credit cooperatives	6,348	2,089	78,576	3,332
7. Central institutions	12	12	32,668	1,224
B. Specialized Banks of which	374	282	288,293	9,549
8. Private mortgage banks	29	29	69,142	1,929
9. Public mortgage banks	16	16	61,375	2,228
10. Banks with special functions	18	18	72,793	2,998
11. Instalment sales financing houses	178	178	11,003	710
12. Private building and loan associations	14	14	33,114	1,030
13. Public building and loan associations	12	12	21,279	654
14. Postal giro and postal savings bank offices	15	15	-	-
15. Other credit institutions*	92	-	-	-
All Banks outside the Central Bank System	7,842	3,491	1,011,862	36,135

*Credit guarantee institutions, investment trusts, central depository banks for securities.

Source: Monthly Report of Deutsche Bundesbank, Sept. 1972.

central bank, but administering assets amounting to almost one-quarter of the total. Within this group the dominating few are the Big Three - the Deutsche Bank, the Dresdner Bank, and the Commerzbank, each with a legally-independent subsidiary in West Berlin. They control over 41 percent of private commercial bank assets, about 14 percent of all commercial bank assets, and nearly 10 percent of the total assets of all banking groups together. The second subgroup consists of the savings banks and their central giro institutions. They represent about 23 percent of the total number of reporting credit institutions and manage just under 37 percent of the total assets of the banking system. The third contains the credit cooperatives and their central institutions. These are many in number but their total assets are not large - about 11 percent of the aggregate.

Finally, among the most important specialized banks are the mortgage banks and institutions with specific tasks. Although mortgage banks number little more than one percent of the total number of credit institutions, they manage assets just 13 percent of the total. The 18 credit institutions with special tasks have assets of just over 7 percent of the total.

Bank Regulation

On January 1, 1962, a new law on the credit system came into force, superseding the Reich Banking Law of 1934 (amended in 1939) and replacing, by a federal authority, the Länder's regional supervision of the banking business.[1] Under the new law no bank may be organized and operated without the written permission of the Federal Bank Supervisory Authority. The two major prerequisites for opening a bank are: minimum authorized capital stock of DM5 million and competent management. Until 1962 the banking authority had the right to decide whether there was an economic need for the establishment of a new bank; however, this provision was found unconstitutional by the Supreme Administrative Court and was rescinded. It is also worth noting here that although the banking authority could refuse a banking licence to a foreign enterprise on the grounds that the German Constitution guarantees the freedom to do business only to indigenous corporations, it has given its approval when it has been shown that the applying bank was of good standing and could provide qualified management for the branch.

Since 1958, banks in Germany have been free from all restraints in organizing branches. Only the saving banks are restricted as to the area where they may open branches; their charters limit them to the towns to which they belong.

The Interest Rate Order, which fixed maximum debtor (loan and overdraft) and creditor (deposit) interest rates, was revoked

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[1] As her name indicates, West Germany is a federated state; it contains eleven Länders or States.

on April 1, 1967. Now the banks are free to quote whatever deposit and loan rates they like. The only constraints are those imposed by the market and the cost/earnings structure of each bank, which limit the interest rates paid or demanded.

In addition, the banks are no longer required to refrain from certain methods of advertising or soliciting new customers, as long as these methods do not violate the federal laws on competition which are stricter than those prevailing in many Western countries.

Commercial banks, irrespective of whether they are private institutions or incorporated under public law, are allowed to accept demand, time and savings deposits, and make commercial, term, consumer, and real estate loans. In this latter connection, it should be pointed out that only mortgage banks and the Girozentralen, the central banks of the savings institutions, can issue and sell mortgage-secured bonds. It should also be added that mortgage banks may not accept regular deposits, which prevents them from granting short-term loans.[2]

The banks of Germany, unlike those of many other countries, can own capital stock in other companies - banks or nonbanks - and they can act as stockbrokers and as underwriters.[3] In practice, almost all transactions in new and outstanding stocks are handled through the banks. As far as the ownership of

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[2]Because their charter was issued in the middle of the last century, two commercial banks - the Bayerische Hypotheken-und Wechsel Bank and the Bayerische Vereinsbank enjoy a special status. Not only do they engage in regular banking business; they also make mortgage loans and have the right to issue mortgage bonds.

[3]A stockbroker acts as a middleman or agent who brings together the buyer and seller of existing shares and receives a commission for his services. An underwriter, on the other hand, both purchases securities outright from an issuer for his own account and risk and sells the new issue to investers.

corporate stock is concerned, German banks are only limited in one way: their total investments in equity securities and real estate must not exceed their own equity capital plus reserves.

Also deserving of mention is the fact that the Law on the Credit System does not impose any limitation on German banks if they want to participate in international consortium business, or set up branches or subsidiaries abroad.

Banking law, on the other hand, does limit the lending activivies of a bank by stipulating that the total amount of its loans must be in certain proportions to its net worth, to its long-term and savings deposits, and to its total liabilities. In addition, all banks are subject to minimum reserve requirements that must be met by holding interest-free clearing balances with the central bank.

Recent Developments

From the perspective of international comparisons, it can be said that German banking laws are quite free. Thus it is not surprising that banks in Germany have in recent years been forced to adapt themselves to uninhibited competition and more sophisticated customers.

One facet of the changed competitive nature of the West German banking system is that the relaxation of branching regulations has resulted in the establishment of branch networks on something approaching the British scale. The 'big three' banks had the sharpest rate of expansion in the period 1957-1972, increasing their number of offices from about 800 to nearly 3,000. The totals for regional and other commercial bank offices, and for foreign banks and their branches rose from about 1150 to 2250 over the same period. The savings institutions as a whole, which had over 9000 bank offices in 1957, opened a further 8000 branches and in 1972 made up nearly 40 percent of the total. The credit cooperatives, which possessed over one-half of all bank offices in 1957, increased their number of offices by more than 4,500, but in 1972 they made up only 44 percent of the total. All this having been said, however, it remains a fact that only four banks have nationwide branches - the 'big three' and the Bank für Gemeinwirtschaft which is owned by the German trade unions and cooperative societies.

This general expansion of banking was also accompanied by an extensive merger movement, especially among private bankers and credit cooperatives. Indeed, the number of cooperatives have been reduced by almost one-half in the interval between 1957 and 1972. Recent mergers among the Girozentralen have now placed the resulting state organizations in a similar size category as the large private commercial banks. It may be useful to add that the Girozentralen have the widest range of banking activities in the Federal Republic; they are permitted to do all things commercial banks and savings banks can do, in addition to selling mortgage secured bonds. It is therefore no surprise that the biggest bank in Germany today is the Westdeutsche Landesbank, the Girozentrale which was formed in 1969 by the merger of the two central giro institutions operating in North Rhine-Westphalia.

Another new development is the stress laid on the service "package". For the savers, banks now offer a broad spectrum of enticements, ranging from premiums and gifts to unit trusts and investment funds offering a choice of as many as 14 different investment/saving possibilities within the one scheme. For the borrowers, banks now provide short, medium, and long-term credit for all types of income and socio-economic groups. Also, an increasing number of banks have established links with institutions offering allied services to banking, such as investment advice, auditing, leasing, factoring, and insurance and travel facilities. In addition, the larger banks have enhanced their increasingly international activities by cooperating in various ways - shared services, joint ventures, specialized subsidiaries, consortia - with banks in foreign countries, and also by establishing branches abroad. In short, the banks of Germany, like those in Britain, are proceeding in measured steps towards true universality and multinationality. In considering the implications of free interest rates it is important to note that Germany, like other countries, has experienced an unprecedented rise of interest rates in recent years. One feature of this period has been a narrowing of the margin between interest due to banks and interest payable by banks; prior to 1967 it had generally widened when interest rates were high. Clearly, competition among credit institutions caused by the decontrol of interest rates played an important part in causing this squeeze. Another has been the substantial change in the deposit mix of credit institutions - an indication that the phenomenon of "interest consciousness" of savers is not peculiar to Englishmen. Also deserving of mention is the fact that the commercial banks have increased their share of the savings market since the freeing of interest rates. The commercial banks' gain was accompanied mainly by a reduction in the savings banks' share. Finally, it should be emphasized that the discount rate of the Deutsche Bundesbank is still an important platform for the computation of debtor interest rates even though - in contrast to the era prior to decontrol - it no longer actually determines the computation of the upper limit of interest rates.

German Banks Abroad

Some time in the 1960's the West German banks decided they ought to strengthen their international position. But having lost many of their branches twice in less than half a century, in 1914 and again in 1939-41, leading German bankers were exceedingly canny about a third overseas foray. As it happened, they approached this task in four ways:

1. Through the intensification of cooperation with correspondent banks around the world;
2. through the establishment of specialized financial institutions in foreign countries;
3. through new forms of cooperation between banks, resulting in the creation of international banking groups;
4. through the opening of full-service branches abroad.

At the present time, West German banks are active in seven big international banking groups, some involved in all kinds of banking operations, others more limited in scope. The European Banks International Company (EBIC) is made up of six banks from six European countries, including the Midland and the Deutsche banks.

The Dresdner Bank and the Bayerische Hypotheken-und Wechselbank (German's fourth largest commercial bank and its most important private regional bank) are two of the four members of the Associated Banks of Europe Coporation (Abecor). The Bayernhypo is also a partner in the ten-member multi-national merchant bank organization, United International Bank.

Probably the closest of the international arrangements is the Europartners group made up of the Commerzbank, the Credit

Lyonnais, the second largest of the three big nationalized French banks, and the Italian Banco di Roma, over 90 percent of which is state-owned. Within this grouping, there is exchange of personnel between member banks and co-operation on every aspect of banking business. It has also established a number of joint institutions abroad, such as the investment bank Europartners Securities Corporation in New York City, whose principal activity is the new issues business, and six joint representative offices - in Singapore, Tokyo, Johannesburg, Mexico, Sydney and Lima. It should be noted that Lloyds Bank has recently intensified its cooperation with the Commertzbank and Credit Lyonnais.

Another grouping is clustered around the constellation Orion, which forms part of the title of the three separate banking ventures set up in London in the autumn of 1970 by the Chase Manhattan Bank, the National Westminster Bank, the Royal Bank of Canada and the Westdeutsche Landesbank. This group has gained two more partners since then: a major Japanese bank, Mitsubishi, and an important Italian bank, Credito Italiano.

The Banque de la Société Financiere Europeenne of Paris and Luxemburg takes in eight banks from as many countries including the Dresdner, Barclays and Bank of America. Founded in 1967, the SFE, as it is generally called, was the first European-based international bank to be established.

Other international banking groups include: the Inter-Alpha group made up of the Berliner Handels-Gesellschaft, and British, Dutch, French and Italian partners; and a group which numbers the Bankhaus Simon of Dusseldorf, the Bayerische Vereinsbank and the Vereinsbank Hamburg among its partners.

In addition to its participation in the EBIC group, the Deutsche Bank has set up two joint subsidiaries for investment and commercial banking in New York - the European-American Banking Corporation and the European-American Bank and Trust Company - and has joint representative offices in other countries. In 1973, it opened two representative offices on its own, one in London and the other in Moscow. It is the Deutsche Bank's current policy to operate no overseas branches at all.

As already mentioned the Dresdner Bank cooperates jointly with the Abecor and SFE groupings. Yet another multi-national organization of which the Dresdner is a founding member is the ABD Securities Corporation of New York and Boston, set up in 1972 to conduct securities trading and investment banking. One of the earliest moves by the Dresdner Bank was the formation of the Compagnie Luxembourgoise de Banque in 1965 to underwrite and deal in Eurobonds, to handle Euromoney transactions, and to help in the formation and management of holding companies. Since then, eleven other German banks have followed the Dresdner's example and set up subsidiaries in Luxemburg. The Bank's latest move was to establish four full service foreign branches - in Singapore, New York, Panama and London - and a representative office in Moscow.

The Commerzbank also has direct branches in Luxembourg, New York and London; the Bank für Gemeinwirtschaft has opened branches in Luxembourg, Vienna, and London; and the Westdeutsche Landesbank has a branch office in London, as well as a joint leasing company.

Undoubtedly, the growth of industrial investment spending abroad by German companies has been a major force in spurring the international expansion of an increasing number of large- and medium-size banks in West Germany. By diversifying their total array of banking services for international business, these banks have improved their ability to maintain their competitive position vis-a-vis large internationally oriented banks headquartered outside the Federal Republic. Expressed in another way, the vigorous expansion in multi-national links forged by German banks in recent years represents the elevation of the "one-stop" banking concept onto the international plane, enabling a group of banks drawn from several countries to cater to the needs of even the biggest of the corporate giants.

The foreign business of German banks has developed very favourably in the past five years. Thus it is fairly certain that even more international banking groups involving German partners can be expected within the next few years and individual German banks are likely to strengthen their foreign branch networks, particularly in countries in which German firms are investing heavily.

Foreign Banks in Germany

The rapid establishment of foreign bank branches in Germany began soon after the lifting of foreign exchange controls in 1958. At the end of 1960 there were just 13 foreign bank branches in the Federal Republic, with a combined business volume of DM 1,000 million. By 1968 there were 22 such branches with a business volume of DM 6,800 million and by the end of 1971 the total had risen to 29 with a business volume of DM 15,400. Their share in the total volume of all banking business in the Federal Republic increased during that period from 0.4 percent to 1.7 percent. At the end of 1971 about 16 of the foreign banks had a volume of business of DM 100 million or more each.[4]

The picture becomes clearer when one breaks down these figures by countries of origin. At the end of March 1972, 30 foreign banks had opened 57 full branches in Germany. Of the 30, nine were American (with 25 of the branches), five British, three each from France and Japan (with a total of 20 branches), and the rest of Belgian, Dutch, Greek, Spanish, Brazilian, Iranian, Hong Kong, Korean and Canadian ownership. The last two years have seen a further expansion in the number of foreign banks establishing branches in the Federal Republic.

In addition to the branches, 30 German credit institutions (regional and other commercial banks, private

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[4]The main source for this section is Deutsche Bundesbank, Monthly Report, April 1972, pp. 19-30.

bankers and installment sales financing houses) were owned wholly or more than half by foreign banks, but most of these were fairly small. There are also about 70 representative offices of foreign banks, located chiefly in Frankfurt, Dusseldorf and Hamburg, which do not themselves engage in regular banking activities but merely negotiate on behalf of their head offices abroad.

In general, the foreign banks are primarily active in the import and export business and in servicing large industrial clients. Thus the bulk of their lending goes to the chemical, oil, steel, machinery and auto industries. In consequence, it is mainly in relation to German subsidiaries of big foreign companies that they compete most effectively with the domestic German banks. It should be added, however, that the American banks are expanding their branch networks in an effort to get in on pure retail banking. At the same time they are emphasizing the advantages of their more personal type of service. In this connection, the Chase Manhattan Bank has recently launched its 'Family Bank Plan' with much fanfare and high hopes for expanding its activities on the retail level.

So far, according to the Bundesbank, foreign banks "have entered into competition with the German banks in the field of deposit business only on a limited scale".[5] It is

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[5] Ibid, p. 26.

largely confined to the wholesale deposit market. But this will inevitably change through closer integration of the German economy with the European Economic Community and the creation of so-called multi-national banks.

It may be useful to note that some foreign banks are involved in servicing the 2½ million immigrant workers resident in Germany, who each month send a considerable portion of their incomes back to their homeland.

Under German law, all branches of foreign banks are treated as domestic banks (several branches of the same foreign enterprise, however, are regarded as only one bank), subject to the same rules and regulations.

To sum up, it is fairly certain that competitive pressures from foreign banks have contributed to stimulating efficiency and imagination in the German banking community, and that Germany is bound to grow as an international banking centre and attract an increasing number of foreign banks.

The Relationship Between Banking and Industry

No account of German banking would be complete without reference to its very close relationship to industrial management. The banks of Germany use their position as large shareholders (both in their own right and by proxy) to participate actively in the conduct of industrial and commercial companies. On the whole, industrial involvement on the part of banks is regarded as a good thing, because it provides a spur to industry to improve its efficiency. According to Dr. Premauer, chief executive of the Bayerische Vereinsbank, the entire reconstruction of the post-war German economy owes a great deal to this relationship. On the other hand, the question has often been raised whether too much intimacy may not be dangerous both for the bank and the enterprise, and also for the economic system.

Before discussing the advantages and disadvantages of the so-called 'house bank principle', it may be helpful to give an idea of the proportion of a bank's resources employed directly in industry. For example, the balance sheet of the Deutsche Bank for 1972 reveals equity assets of DM 1.1 billion, which was around 3 percent of total assets. For the Dresdner Bank, the aggregate value of its shareholdings amounted to DM 1.3 billion, representing about 4 percent of the entire 1972 balance sheet. At the end of 1972 the Commerzbank held DM 682 million of shares, or just under 2 percent of its total assets in this form. But a caveat is in order here. German banks do not show their equity position in subsidiaries and affiliated companies under the item 'share holdings' but as 'participations'. For the Dresdner Bank, the balance sheet value of its 'participations' in subsidiaries and other financial institutions amounted to DM 362 million at the end of 1972 - to give but one example.

While the German banks' aggregate industrial shareholdings only represent about 5 percent of the total market value of all listed German shares, they are still important shareholders in many large trading and industrial concerns. For example, the

Deutsche Bank alone owns 25 percent or more of the share capital of the following large corporations; Germany's biggest shipping company, Hapag Loyd; the large sugar company Suddeutsche Zucker; and one of the two largest department store chains, Karstadt. Another 25 percent of the latter is held by Commerzbank, which at the same time is a major stockholder in the other big department store chain, Kaufhof. Furthermore Commerzbank is involved as shareholder in breweries, a construction firm, a hotel chain, and many other enterprises. The Dresdner also owns at least 25 percent of Hapag Loyd and Kaufhof and about 15 other enterprises. The Bayerische Vereinsbank holds 25 percent or more of the shares of 14 industrial companies. There is no need to extend this litany further. Enough has already been said to make the point that the banks of Germany are substantial shareholders in major sectors of German industry.

In addition, we should bear in mind that some 80 percent of all shares owned by private individuals are held in safe custody at private commercial banks. And it is the custom for the banks to exercise the voting rights for such shares. This, of course, makes it possible for the banks to have their officers elected as directors of the companies.[6] Since 1966,

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[6] In Germany those people elected to represent the stockholders are referred to as members of the 'supervisory board' and they are not concerned with the routine of operations. In other words, the board has a purely supervisory function over the more fundamental aspects of the company's activities.

the number of directorships one person can hold is limited to ten. Before leaving this voting matter, it should be pointed out that when a shareholder has given his bank the power-of-attorney to use the voting rights for his shares, this proxy must be renewed every 15 months. This is a binding legal provision.

Let us now consider the opposing views about the relationship that should exist between the management of money and the management of business. Those who take the integrationist view argue that (1) this is the most efficient approach, since the bank shares responsibility with industrial management for ensuring that poor performance does not persist; (2) it enables lending decisions to be based on sound knowledge of the risks involved in each industry in which the bank has an interest; and (3) it is the best way of safeguarding the interests of the small shareholder.

Those who oppose the integrationist view argue that this approach will bring (1) less sound banking operations; (2) credit favouritism, coercive tie-ins, cross-subsidization, etc., (3) unfair competition to small firms; (4) massive concentrations of economic power, and (5) impairment of monetary policy.

Clearly, judging the effects of the close relationship between banking and industry in Germany is a complicated problem which is largely beyond the scope of this paper.

Nevertheless, several observations are worth stressing here. First, an integrated bank in no way removes itself from the full weight of banking legislation. In this connection, it is worth noting that the officials engaged in the supervision of banks in Germany will tell you quite clearly that they have adequate powers under the Federal statutes to prevent the sort of abuses, the sort of self-dealing, the sort of preferential lending between the banks and the affiliated concerns which might result in a threat to safety and solvency.

Second, for so-called "tie-in" arrangements to be effective, a bank must have monopoly power. If a customer can switch to another bank when his 'house' bank requires him to make use of its other services as a condition for a loan, then 'full-line forcing' will be ineffectual. Also, the simplistic notion that banks will 'bail out' closely related companies in serious financial trouble can be rejected because it flies in the face of accepted principles of modern bank management.

Third, combining banks with related and unrelated businesses may lead to important advantages of scale. If these economies are real, society benefits - provided that competition remains effective and obliges the integrated bank to pass the economies along to the public via lower prices or product improvement.

Fourth, concern that integration will lead to dangerous aggregations of economic and political power overlooks the fact that most of the world's major industrial countries now have anticombines and antitrust legislation, i.e. laws relating to combines, mergers, monopolies and restraint of trade. Although both the vigour of the policies and the degree of emphasis with which they address themselves to particular business practices and situations vary considerably from one country to another, it remains true that such legislation reflects an awareness of the special public interest in the conduct of 'dominant firms'. In most countries, such firms are subject to supervision or regulation, an approach sometimes described as preventing the "abuse of dominant positions". It should be added that concern with super concentration also ignores the natural forces of competition from other strong and well-integrated banks. For this reason one might easily argue that the greater the number of integrated banks formed the better.

Finally, it should be pointed out that there has been no evidence presented which establishes that integration is detrimental to the credit policies of the monetary authorities. Indeed, the opposite may be true, inasmuch as the very increase of the range of choice for both lenders and borrowers may increase the mutual interdependence of all money and credit markets and intensify the sensitivity of the whole structure to central bank weapons.

Before leaving this issue, it may be of some value to note that Mr. D.E. Wilde, Vice-Chairman of Barclays Bank Ltd., told a large group of British bankers on December 5, 1972, that:

"I think it is a good thing for a bank to take an equity interest in a developing company, to give it support until it has grown to a size when it can go to the market, or for a bank to come in good time to the aid of a company which finds itself in difficulties. I think it is quite another thing for banks to take up a position as a substantial, permanent shareholder in large sections of British industry. Such a situation would create far too great a concentration of economic power in the hands of a single organization, and for my part, I am against it. One does see now a great deal of comment about the German banks, the Japanese banks, and their close involvement in the management of industry in their own countries. But of course, the background there is quite different. I do not know if the German banks should have welcomed the situation in which they found themselves and which I think started in the 1930's, and which was a rescue operation. But certainly in this country conditions are quite different, and I think it would be a great pity if the banks were to get involved in the equity market on too big a scale."[7]

This last point was made even stronger when the then Governor of the Bank of England said one month later:

> "..one can sympathise with the desire to see pressure through the medium of the banking system being brought to bear on industry to improve its efficiency. This is a vitally important objective which has got to be achieved somehow, and, as you know, I have so far had only moderate success in persuading the institutional investor to take on this task. I shall persevere but I would not think it right to seek to persuade the banks to become large-scale equity investors in industry so that they may do the job. I prefer the banks to run their business primarily with the accent on liquidity and with the safety of their depositors in mind, as our banks always have done".[8]

Be that as it may, the big German banks have considerable industrial expertise and are prepared to exercise

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[7] Competition and Credit Control, Seminar, December 5, 1972, Gillet Brothers Discount Company, London, p. 10.

[8] Speech delivered at Institute of Bankers in Scotland on January 22, 1973 (see Bank of England, Quarterly Bulletin, March 1973, pp. 57-58.

their powers to influence and, if necessary, effect changes in management of companies in which they have an interest. For the bank, equity interests provide greater security; for the customers they have the benefit of expert advice informed by an intimate knowledge of their company. Or, to put the same point another way, bank surveillance of industry is more efficient - for the economy - than the stock markets.

Conclusions

There can be no doubt that the relaxation of official controls over banking operations between 1958 and 1967 had a considerable influence on German banks. In particular competition for deposits has been greatly stimulated. Banks now compete for deposits through interest rate variations as well as through advertising and the provision of branch networks. The resulting convergence of deposit and lending rates has caused all banks to implement cost-reducing innovations and product improvements, to make full use of management, and to seek out new demands of consumers. Each of these responses has contributed to the more efficient use of national resources. It is equally clear that the freeing of interest rates in 1967 by itself has not rendered German credit policy ineffective.

Besides providing an appropriate atmosphere for the development of inter-bank competition, the new freedoms served to promote the concept of universal banking. Indeed, aside from the pure mortgage banks and the specialized institutions, the multi-purpose bank is now typical of Germany. In short, the banks of Germany can offer the private saver the entire range of investment - from savings deposits to securities, while providing almost every type of service and financing for companies from the classical forms of bank lending to the placing of stock and bonds.

The most striking development in German banking in recent years has been the forceful growth and diversification of international financial activities. In consequence, the banks of Germany are moving towards a structure that more closely matches the needs of their major industrial customers who are themselves spread with increasing internationality. Whether this is best achieved by engaging in consortia or by independent action will be left for each situation to determine; the end result will be an integrated package of services available to customers anywhere in the world.

The establishment of foreign banks in Germany and the acquisition by foreigners of interests in German banks are of comparatively little, though increasing, importance. It suffices to say that the foreign presence has instilled an additional element of competition into certain specialized areas of the German banking scene. Another important point is this; "foreign banks are neither better nor worse placed than German banks with regard to bank supervision and the monetary regulations".[9] In short, the German authorities have established reciprocity for the freedoms their banks enjoy in many countries abroad.

A tendency towards concentration is evident in all sectors of the banking industry, but it is most noticeable

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[9] Deutsche Bundesbank, Monthly Report, April 1972, p.20.

among the cooperative banks, the central giro offices and the regional banks. The financing of the growth of domestic enterprises and the increasing activity of the banks abroad both call for strong institutions with a broad and widely diversified deposit base, so that one may expect this movement towards larger units to continue.

One of the most distinctive features of German banking is its very close relationship to industry. Or to put it differently, Germany has a bank-dominated rather than stock-market oriented economy. In consequence, banks in Germany have much more power over individual companies - and especially over actions by individual corporations with inefficient 'supervisory boards' - than bankers have in Britain or America. It is traditional in London to say that this difference shows that America and Britain have "more sophisticated capital markets" but to judge from the post-war record of West German industry, the influence of the banks has been very much to the benefit of the Federal Republic as a whole. Yet, it is also true that the power of the big banks in Germany has often been attacked, both from the left and the right. As might be expected, the German bankers have answers for most of the criticisms. However, there are considerations among the major banks on how their equity holdings can be reduced, with the aim of promoting a broader ownership of industrial assets and also of reducing the scope for attack. Of course, there is some hesitancy to impose changes on a system that has a long tradition and so far has proven its efficiency, especially when there is already visible a trend towards greater industrial involvement on the part of banks in Britain.

Relevant German Financial Institutions

In this section I examine the role of the youngest among the large commercial banks of Germany and one of the specialist banks to see if we have something to learn from them. Since Germany is the country of universal banking, let us start with the Bank fur Gemeinwirtschaft.

Bank fur Gemeinwirtschaft (BfG)

The BfG, the share capital of which is held by the German Federation of Trade Unions and its 16 affiliated unions (93%) and by the Bulk Purchasing Company of the German Consumer Cooperatives, stands between Germany's three biggest banks on the one side and the big regional banks on the other. Since some of the forces determining the present role of this bank are found in earlier periods, some historical allusions will be helpful.

Workers' mutual aid banks had been founded in Germany prior to the First World War. Afterwards the first trade union banks appeared. During the Nazi regime, from 1933 to 1945, these banks were closed and were not re-established again until the beginning of the fifties. At this time the form of universal business banks pursuing commonweal goals was adopted.[10] In 1958 the six regional commonweal banks merged to form one unit under the name Bank fur Gemeinwirtschaft at Frankfurt am Main. The consolidated assets of the new bank were over DM 2,000 million.

The business structure of the BfG may be compared to three over-lapping circles: The inner sphere consists of the "house banking" function, on behalf of the trade unions and of other commonweal enterprises. As such, it administers their deposits, grants credits and procures new capital. The second circle represents all lines of banking for the general public. This function is strengthened by an extensive network of branches throughout the Federal Republic, a branch in London and several representative offices in key financial centres abroad. The third region delineates the bank's participations. These consist of banks and finance companies in Switzerland, Israel, Luxemburg, Austria and the Netherlands, a merchant bank, two finance companies, two mortgage banks in Germany, three insurance companies, and a travel agency. In addition, it owns one third of the stock of the wholesale company of the German consumer cooperatives. These participations not only extend the business possibilities of the bank but are an instrument of cooperation with trade union and cooperative institutions abroad.

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[10] In Germany the term "Commonweal" is used to denote all organizations and enterprises pursuing aims of public welfare as opposed to maximizing profits.

Total assets of the BfG amounted to DM 17,604 million at the end of 1973. The bank's own funds (share capital and published reserves) amounted to DM 647 million at the same date. Of the total volume of lending, about 9 percent is accounted for by the enterprises committed to the public welfare, while the bulk of the loans go to private industry. Second to these rank the loans to the wholesale and retail trade, which are followed by housing loans, consumer loans, and loans to public enterprises and credit institutions.

It is now very widely agreed that the commonweal banks were pioneers of installment credit; they offered very favourable conditions to the public in this field and thus exercised a certain pressure on the general level of interest rates. It may be useful to add that if a customer of the BfG has been a member of a trade union for three consecutive years he is entitled to obtain a personal loan at a cheaper rate than those who have not been.

The BfG also acted as a pioneer in promoting savings activities. Besides offering the usual savings outlets (i.e. deposit accounts, fixed-interest bearing securities, investment certificates and shares of stock) it added the "savings bond certificate" and the "capital savings book". The savings bond certificate combines the advantages of the normal savings book with those of a fixed-interest bearing security. This means a combination of security and high interest yield without any market risk. Both the savings bond certificate and the capital savings book offer rising rates of interest over their term, and may be encashed at the bank at any time.

In addition, the BfG was the first bank to (1) introduce a "one stop home financing service", (2) raise interest rates after the ceiling on deposits was removed in 1967, and was one of the first German banks to (3) develop term lending.

To return to participations; it is the practice of the BfG to acquire shares in industrial companies in financial difficulties, if the industrial base of the enterprise is sound. Not only will this help a client, but it will also protect the jobs within that firm for union members. Once the firm is financially solvent, the BfG will sell off those shares. Put another way, permanent participations are made only if they are connected either with the services usually rendered by banks or with the activities of trade unions and consumer cooperatives. In short, it is the philosophy of the BfG not to participate in the formation of industrial policy in Germany. In this connection, it should be noted that there is no industrial representation on its supervisory board.

In sum, the BfG is a universal bank with a difference. It was set up to serve as a competitive spur to the traditional German banks and, in retrospect, it seems that it has served this purpose well.

Kreditanstalt fur Wiederaufbau (KfW)

Perhaps the most important of the 18 banks with special functions is the Kreditanstalt fur Wiederaufbau (Reconstruction Loan Corporation) founded as a public-law corporation in 1948. Its present authorized capital is DM one billion, 80 percent of which is held by the federal government, the remaining 20 percent by the Lander authorities. It has its seat at Frankfurt am Main and maintains no branches.

Its original purpose was to provide loans, insofar as other credit institutions were unable to raise the necessary funds, for the reconstruction or development of the economic system. In 1951 it started granting medium and long-term loans to German exporters. And in 1961 it commenced granting loans to finance worthwhile development projects abroad. In short, it has now assumed the function of a federal development bank. This institution obtains its loanable funds from two sources, public funds (i.e. ERP Counterpart funds - Marshall Plan funds - and federal government and Lander funds) and its own funds (i.e. monies derived from the regular repayments of loans and monies raised on money and capital markets and from institutional investors. It is also empowered to borrow in foreign countries and from the Deutsche Bundesbank, but it is not permitted to take deposits, to engage in current account business, or to deal in securities for the account of others. On December 31, 1971, its total assets amounted to about

DM 25 billion and its loans outstanding to close on DM 12 billion.

Let us now turn to a more detailed consideration of the KfW's activities. On the domestic side, one of its chief functions is to promote the financing of small business enterprises. It grants loans for the rationalization of industry, changes in manufacturing range, and technical improvements. In general, it only supplies medium- and long-term finance. It is also the bank's policy to provide only a part of the financing required. As a rule, the KfW puts up between 30 and 40 percent of the necessary funds for a particular investment project. The balance of the funds must be obtained elsewhere, either in the capital market or at the commercial banks. The KfW is also responsible for financing several regional development projects. Funds for such projects are provided from the federal budget. The guidelines for these development schemes are established by the federal government and the bank jointly. The KfW also finances house building in specified areas.

In this context, it should be pointed out that all KfW lending is channelled through the commercial banking system. That is to say, an enterprise seeking financing from the KfW will first approach its commercial bank which in turn will pass along the request to the KfW. If the KfW approves the request, it will supply the funds. However, the commercial bank which referred the loan application will guarantee its repayment.

Thus, the KfW bears no capital risk. The commercial bank receives a fee, usually one percent of the amount involved, for its referral work and for its contingent liability.

Another important point is this: all KfW programs involve subsidized interest rates. In short, those who are able to borrow at the KfW do so at rates normally below those charged in the capital market or by commercial banks. This policy is intended to help small and medium sized firms obtain funds on the same basis as large and well established enterprises.

From time to time, the KfW is involved in "ad hoc" financial transactions. For example, the federal government may undertake a particular project - say, the acquisition of new aeroplanes for Lufthansa airlines. If the government is unable to supply the funds through a budget allocation, it may direct KfW to finance the project itself. In such circumstances, the KfW has little recourse but to accommodate the government.

Concerning its external role, the KfW offers two types of services: capital aid and export credit to foreign purchasers. With regard to capital aid, several ministries are usually involved: the Ministry of External Affairs, the Ministry of Economic Cooperation, and any other ministry which happens to be involved in a specific aid project. The activities of these various ministries are coordinated by several inter-ministry committees which deal with aid to developing countries.

Thus, in practice, the KfW receives its direction and reports to these inter-ministry committees and not to particular ministries directly. For example, the KfW might be asked to evaluate a specific project in a developing country. It would then bring to bear its considerable expertise and render a judgement on the feasibility of the project. Its report would then be forwarded to the inter-ministry committee concerned which would render a decision. If that decision was in the affirmative, the KfW would be directed to undertake the financing involved- even if its own judgement about the project has been negative. It is important to note here that the KfW is only responsible for the financing of capital projects. All forms of technical assistance to developing countries is handled by another agency, the Federal Office for Development Aid. This office disperses about DM 400 million per year whereas the KfW dispersed about DM 1.3 billion in 1972.

One general remark should be made in concluding this section of the paper. By its charter, the KfW is suppose to be a complementary financial institution, but in some ways it is a source of competition to other financial agencies in Germany. The fact that its rates are lower than other financial institutions means that its lending programs are very attractive to those enterprises which are eligible to apply for them. Thus the KfW is a direct competitor of the other banks with respect to business loans and, to a lesser degree, home financing.

In sum, the KfW is an important element in the German financial scene, and has several features which could be copied by Canada.

ADDENDUM : WESTERN GERMANY

Despite the prolonged business slump which only bottomed out during the summer of 1975, the German banking system has greatly increased its volume of business since 1972. The change becomes clear when we compare the total assets of the banking system in mid-1972 (see page 59) with the end of 1975 (as shown in the following table). This table also clearly illustrates the relative importance of the three main banking groups and the several sub-groups. In addition, it shows that the trend toward fewer banks, especially among the private bankers and credit cooperatives, has gained momentum. While the bank contraction movement in Germany has been effected mainly through merger and amalgamation, failures have played a larger role since 1973.

Survey of the German Banking System

Banking group	Volume of business in DM 1,000 m.	Volume of business Market share in %	Lending to non-banks in DM 1,000 m.	Lending to non-banks Market share in %	Deposits and borrowings from non-banks in DM 1,000 m.	Deposits and borrowings from non-banks Market share in %	Banks	Branches	Bank offices total
Commercial banks	**356.7**	**24.5**	**205.3**	**22.4**	**192.6**	**24.4**	**285**	**5,824**	**6,109**
Big banks¹) ("Big Three")	143.7	9.9	85.0	9.3	101.9	12.9	6	2,991	2,997
Regional banks and other commercial banks	151.6	10.4	94.1	10.3	74.5	9.4	110	2,496	2,606
Branches of foreign banks	33.7	2.3	10.6	1.2	3.1	0.4	49	39	88
Private bankers	27.6	1.9	15.5	1.7	13.1	1.7	120	298	418
Central giro institutions	245.3	16.9	160.9	17.5	48.6	6.2	12	345	357
Savings banks	**322.1**	**22.1**	**201.6**	**22.0**	**283.0**	**35.8**	**675**	**16,382**	**17,057**
Central institutions of credit cooperatives	63.6	4.4	14.2	1.5	7.3	0.9	12	83	95
Credit cooperatives	**136.1**	**9.4**	**84.2**	**9.2**	**115.5**	**14.6**	**5,196**	**14,254**	**19,450**
Mortgage banks	181.3	12.5	165.3	18.0	55.8	7.1	41	30	71
Instalment sales financing institutions	16.6	1.1	14.2	1.5	3.8	0.5	141	436	577
Banks with special functions	103.1	7.1	57.3	6.2	56.3	7.1	19	31	50
Postal giro and postal savings bank offices	30.0	2.1	15.0	1.6	26.6	3.4	·	·	·
Total	**1,454.8**	**100.0**	**918.0**	**100.0**	**789.5**	**100.0**	**6,381**	**37,385**	**43,766**

All figures as at December 31, 1975; ¹) including subsidiaries in Berlin West;
Source: Monthly Report of the Deutsche Bundesbank; Statistical section III.

This seems as good a point as any to comment on the soundness of the German banking system. The danger signals first became apparent in 1973 when a small private bank- Bau - closed its doors, the Westdeutsche Landesbank Girozentrale lost 270 million Deutsche Marks by playing the volatile foreign exchange markets, and the Hessische Landesbank Girozentrale got into financial difficulties as a result of losses incurred by the industrial investment bank, Investitions und Handelsbank, in which it had a large stake. In June 1974, the failure of I.D. Herstatt of Cologne, the country's biggest private bank, for unauthorized foreign-exchange operations, jolted the German banking system to its very foundation. This was followed by the collapse of four other small private banks - Bass, Herz, Wolff-Hamburg and Wolff-Frankfurt - for a variety of reasons. The closure of Herstatt caused heavy losses to depositors - depositors received between 40 and 60 percent of their claims - and resulted in substantial foreign exchange losses for many banks (among U.S. banks, Seattle First National Bank lost $22 million, Morgan Guaranty $13 million, Girard Trust $5 million), and the forced merger of the Israel-British Bank (London) with the Bank of Israel, the Israeli central bank.

Faced with a situation which threatened to throw international doubt on the creditworthiness of all German banks, the Deutsche

Bundesbank formed a consortium with a capital of a billion marks (almost $400 million) to support any sound bank which might experience liquidity difficulties. Further defensive moves were taken to curb foreign exchange trading by all banks - their forward exchange "open positions" were limited to 30 percent of their share capital plus reserves - and a statutory bank deposit insurance fund was proposed. Subsequently an amendment to the banking law in May 1976 provided the necessary legal footing for a voluntary scheme of deposit guarantees worked out by the German private banking association. Whereas previously a depositor with a German commercial bank was guaranteed only up to a ceiling of 20,000 Deutsche Marks, now the deposits of a private individual, a company or a public authority will be covered up to 30 percent of an insolvent bank's capital and paid in surplus. The essential force of this change is suggested by an illustration; if the new system had been in effect when Herstatt failed, depositors would have received up to 21 million Deutsche Marks of their deposits, or about 1,000 times more than they were entitled to under the former so-called "firefighting fund". In brief, private depositors with German commercial banks will in future be effectively guaranteed in full against loss in the event of a bank insolvency. In this context, it should be added that the German savings bank and cooperative bank associations already offered virtually complete protection to any depositor against loss.

The top German banks have speeded up the process of establishing branches outside the country and thus have expanded their foreign business. Moreover, the prospects for further expansion of their international business is good. As further evidence of this development, it is worth noting that the Commerzbank opened a representative office in Moscow in 1975, and the Bank für Gemeinwirtschaft, Germany's ninth largest bank and its leading commonweal bank, established a full-service branch in New York in May 1976. Equally important, the German banks have increased their participation in the international banking groups. For example, the Deutsche Bank has a stake in the Commercial Pacific Trust Company Ltd. (COMPACT) of Port Vila, New Hebrides formed in 1974. The other partners in COMPACT are The Toronto Dominion Bank, the United California Bank, the Commercial Bank of Australia Ltd., The Fuji Bank, The Trustees Executors and Agency Company Ltd. and the Euro-Pacific Finance Corporation Ltd. Furthermore, the Europartners group, of which Commerzbank is the German partner is meeting the "American challenge" in Europe by using a concept which aims at offering an integrated branch system; it has also become an important factor in large-scale international financing.

Conversely, there were 49 foreign commercial banks operating 88 offices in Germany as of the end of 1975. And their share in the total volume of all banking business in the Federal Republic was 2.3 percent in 1975, compared with 1.7 percent in 1971.

The heated debate about the participations held by German banks in industrial, commercial and transportation companies is still going on. However, according to a 1975 survey conducted by the Federal Association of German Banks, the majority of customers using security deposit facilities are in favour of the present practice of the banks representing shareholders at the annual general meetings of business corporations. More than 80 percent of the nearly 600,000 customers who replied to the Association's questionnaire voted for the retention of the existing procedure, whereby shareholders authorize the bank with which the securities are deposited to represent their interest at the appropriate times. Similar results were obtained from a Commerzbank survey. However, 9.7 percent of those responding to Commerzbank contended that in important cases the voting right should be exercised only on the basis of specific instructions. About 5 percent of the Commerzbank customers wished in all cases to give definite advice to the bank (which they are free to do under the present system). In short, the vast majority of respondents to the two surveys favoured the status quo. The results also reflected considerable confidence in the German banks.

To sum up, the large German banks not only provide the best example of the 'universal' banking concept, but the Federal Republic now boasts of the safest banking system in the world.

AUSTRALIA

In the past few years there have been some fundamental changes in the Australian capital market. Many of them have had a material bearing on the role of the trading banks (the term 'trading bank' is common parlance in Australia for what are called 'commercial banks' in other countries) in the financial system. But before examining these changes the institutional setting must be briefly sketched.

The Banking Structure

In Australia, four main types of banking institutions can be distinguished on the basis of their principal functions - the central bank (The Reserve Bank of Australia), 13 trading banks, 12 savings banks, and 2 development banks. In addition there is a variety of other financial institutions to deal with the particular needs of agriculture, house construction and consumer transactions.

Central banking: The Reserve Bank of Australia's functions and responsibilities derive from the Reserve Bank Act 1959 and the Banking Act 1959, which came into effect in 1960. They have their origins, however, in the development of the former Commonwealth Bank of Australia over the previous half-century.

The Commonwealth Bank was established in 1911 as a federal government savings and trading bank. In 1920 control of the note issue was transferred from the Department of the Treasury to the bank. Through the powers it had under the Commonwealth Bank Act 1924, and through its wartime powers under National Security Regulations 1941, the bank emerged as a fully-developed central bank.

The Commonwealth Bank Act 1945 formally constituted the bank as a central bank. These powers were carried through into the present Act constituting the Reserve Bank. However, substantial changes in the organization of the bank have been made, principally to separate the bank's central banking and trading activities. This transition was completed in 1960, when the Reserve Bank Act 1959 and the Commonwealth Bank Act 1959 came into operation.

The two Acts provided for (a) the complete separation of the central bank from the Commonwealth group of banking institutions and its reconstitution together with the Note Issue Department and the Rural Credits Department (established in 1925), as the Reserve Bank, and (b) the establishment of the Commonwealth Banking Corporation, with responsibilities for the non-central banking activities that had been developed with the original Commonwealth Bank - namely, the Commonwealth Trading Bank, Commonwealth Savings Bank and Commonwealth Development Bank.

In general, the Reserve Bank of Australia's duties, powers and activities are similar to those of central banks in other countries. They include the regulation of the monetary and banking system; the management of the currency; performing banking and other services for government, acting as banker to the trading and savings banks; providing facilities for the final settlement of interbank debts; the mobilization of gold and foreign exchange resources and the administration of exchange control. Through its Rural Credits Department, the Bank makes short term loans to statutory marketing boards and cooperative societies of primary producers.

The present regulation of monetary forces in Australia is provided by a two-tier system. Each trading bank is required by the Banking Act to maintain a deposit account with the Reserve Bank, the minimum depending upon the total amount of deposit liabilities outstanding. In addition, each of the major trading banks have agreed to maintain on a monthly average basis a minimum ratio of liquid assets (cash, treasury bills and government securities) to deposit liabilities.[1] By changing the statutory reserve deposit ratio the central bank can alter the level of the trading banks' liquid assets and control their availability to expand credit. The reserve Bank's transactions in the open market can also be used to influence bank liquidity. It should be added that the Reserve Bank is empowered to direct the overall lending policies of both the trading and savings banks, and it may likewise set the terms on which banks borrow and lend.

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[1] At the present time, the trading banks have an understanding with the central bank to maintain at least 18 percent of deposit liability in the form of cash or government securities.

<u>Commercial Banking</u>: The trading bank framework consists of the Commonwealth Trading Bank, six big private trading banks, three state government trading banks and three other cheque-paying banks. The biggest private trading banks are the Bank of New South Wales, the Australia and New Zealand (ANZ) Banking Group Ltd., the National Bank of Australasia, the Commercial Banking Company of Sydney, the Commercial Bank of Australia and the Bank of Adelaide. These banks, together with the Commonwealth Trading Bank are generally referred to as the major trading banks.

The three state government trading banks are the Rural and Industries Bank of Western Australia, the Rural Bank of New South Wales and the State Bank of Australia. These banks operate under state governmental jurisdiction and are not generally subject to Reserve Bank powers deriving from federal legislation. The Reserve Bank does, however, maintain close contact with them and fosters their cooperation in giving effect to its policies.

The other trading banks are the Brisbane Permanent Building and Banking Co. Ltd., a joint stock company which has specialized business in one district only; and the Bank of New Zealand and the Banque Nationale de Paris, which are branches of state-owned overseas banks and which transact limited business in Australia, being mainly concerned with financing trade between Australia and other countries. In this latter connection, it should be mentioned that the Taiwan-based Bank of China was closed in 1972 following the diplomatic recognition of the People's

Republic of China by the Government of Australia.

There are about 4,800 branches and 1,600 agencies of trading banks in Australia. The seven major trading banks are responsible for over 90 percent of ordinary banking business.

Savings Banking: The largest savings bank is the Commonwealth Savings Bank of Australia, holding roughly 40 percent of the total savings deposits. The state savings banks in Victoria, South Australia and Western Australia do about 22 percent of the business, and the savings subsidiaries of the six private trading banks about 37 percent. The remaining savings deposits are held by two trustee savings banks in Tasmania. These banks are required to maintain at least 60 percent of depositors funds in liquid items and government and semi-government securities. They may invest up to 40 percent of the balance of deposits only in loans for housing or other purposes on the security of land, or in government-guaranteed loans.

Development Banking: The Commonwealth Development Bank of Australia, which took over the business of the Mortgage Bank and Industrial Finance Departments of the former Commonwealth Bank in 1959, provides medium to long-term finance for primary production and the establishment and development of industrial enterprises (particularly small ones) where such finance would not otherwise be available on reasonable terms.

The Australian Resources Development Bank was created by the major trading banks (with support from the Reserve Bank of Australia and two state trading banks in the form of loan capital) in 1967 to provide finance for large-scale projects of national importance.

Other financial institutions: Other important financial intermediaries are life insurance companies, pastoral finance companies, installment credit companies and building societies.

The Stock exchanges also play an important part in facilitating the raising of investment funds by companies and by government authorities, in that they ensure a ready market and easy negotiation of securities issued. Each of the state capitals has its independent stock-exchange.

There are nine companies authorized by the Reserve Bank to act as dealers in the short-term money market. They accept loans overnight, at call or for fixed periods, in amounts of at least $A50,000. They invest the funds in federal government securities with maturities not exceeding three years, and in commercial bills accepted or endorsed by a trading bank. The Reserve Bank makes loans available to these dealers under "last resort" arrangements.

Banking Developments since the 1950's[2]

The 1950's and the early 1960's were difficult years for the commercial banks. The federal government attempted

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[2] This section follows D.H. Merry, "Monetary and Banking Developments in Australia in the 1960's", Australian and New Zealand Association for the Advancement of Science, 44th Congress, Sydney, August 1972.

to pursue an anti-inflationary policy by a mixture of fiscal and monetary measures which relied heavily on direct controls over bank loans and the rates of interest paid or received by banks. The inevitable results of these restraints on the banking system were the growth and multiplication of the so-called "non-bank" financial intermediaries, the development of direct loans between companies,[3] and the subsequent contraction of the Reserve Bank's area of control.

In 1961 the Australian economy turned down. As a consequence, the government accepted some freedom for the banks and a more flexible use of the interest-rate weapon. In April 1962, bank overdraft rates were partially freed by removing the edict that the average of all rates actually charged to customers should not exceed 6 percent, but the maximum rate of 7 percent was retained; bank deposit rates were reduced by one-quarter percent, thus widening the margin between deposit and overdraft rates. More significantly, term loan fund accounts were established with the Reserve Bank to enable major trading banks to make fixed term loans for capital expenditure on production in the rural, industrial, and (to a lesser extent) commercial fields, and to finance exports. This was a marked departure from the usual commercial bank practice in Australia under which lending was generally on an overdraft

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[3] As noted earlier, the term "disintermediation" is usually applied to an inter-company loan market.

basis. (Nominally at call, overdrafts are in practice much more flexible). Initially, the amount earmarked for term lending was $A114 million, equal to 3 percent of bank deposits, 2 percent being provided from each bank's statutory Reserve Deposit account at the Reserve Bank and the remaining 1 percent from its other assets. Further transfers have since been made to the Fund from these sources, bringing the total at June, 1973 to $A755 million. The fund is a revolving one and repayments are available for new lending. In short, term loans (varying usually between three and eight years) have now become an important adjunct to normal bank lending by overdraft.

In 1964, the major trading banks, in conjunction with the central bank, established the Australian Bank's Export Refinance Corporation Ltd., to meet demands for export credit, particularly for large amounts over extended periods. This facility has enhanced the competitive ability of Australian exporters, particularly exporters of capital goods, and has become an important aid in Australia's current export effort.

During the same year, the Reserve Bank saw fit to relax the terms of the trading bank deposit structure. In April 1964, new term deposits from one to three months were permitted for amounts of $A100,000 and over, thus allowing the banks a measure of competition against the short term money market. In September 1964, the banks were authorized to accept deposits up to 24 months. For several years the maximum term had been

15 months. Both extensions, however, were of relatively limited competitive significance, because, in neither case, could the maximum permitted rate of interest be regarded as a market rate.

In 1965, official approval was given for the development of a commercial bill market. The banks were able to accept, endorse or discount bills, and authorized dealers in the market were permitted to trade in, and hold commercial bills of exchange up to a stipulated proportion of their portfolios. The banks, however, were prevented from establishing their own bill discounting houses.

During 1966 discussions involving the federal government, the central bank and the major trading banks resulted in the creation of another special fund known as the Farm Development Loan Fund. Resources from this fund are available to provide rural producers, particularly smaller farmers, with greater access to medium and long term finance. These loans are mainly directed to developmental purposes which will raise productivity. Loans are made up to 15 years, with longer periods possible in special cases. It should be added that these loans are additional to those available on overdraft and from the Term Loan Fund. At the outset, the amount transferred to the Farm Development Loan Fund was $A87 million. Two-thirds of each bank's share was provided from its Statutory Reserve Deposit account and the remainder came from its other assets. Additional transfers have subsequently been made to the fund from these sources, bringing the total at June 1973 to $A217 million.

There were several significant developments in 1967. In March, the trading banks were allowed to make unsecured personal loans of up to $A1,000 at interest rates not subject to the maximum overdraft rate. In August, they were granted permission to provide bridging loans at competitive rates of interest. In November, they set up the Australian Resources Development Bank to assist local enterprises to participate more fully in the development of Australia's natural resources.

Further progress was made in extending the range of bank lending facilities in mid-1968 when official approval was given to banks to undertake lease financing of plant and equipment on a modest scale.

The following year the authorities allowed the trading banks to issue marketable Certificates of Deposits in denominations of $A50,000 and over for terms from three months to two years with a maximum interest rate (then) of 4.75 percent. At the same time, authorized dealers in the short term money market were permitted to hold a limited proportion of their portfolios in this new type of credit instrument. Certificates of Deposits were introduced to help banks compete more effectively with money market institutions and with the rapidly developing business in inter-company lending.

During the same year approval was granted for the merger of the Australia and New Zealand Bank and the English, Scottish and Australian Bank to form Australia and New Zealand Banking Group. In addition, certain adjustments were made to the term and rate structure of trading bank interest bearing term deposits. In particular, the concept of a large deposit was extended to the whole range of term deposit maturities and a separate rate structure for "large" and "small" deposits was established. A new type of savings bank account was also introduced offering interest rates substantially above the general deposit rate. These accounts, called Investment Accounts, were to be subject to special requirements in respect of notice of withdrawal, minimum balance and minimum amounts for transactions.

In March 1970, the minimum size for large interest bearing term deposits was reduced from \$A100,000 to \$A50,000. In April of that year savings banks were allowed greater flexibility in determining their deposit interest rates, subject to a ceiling rate of interest, and the maximum amount in any one account on which savings banks may pay interest was increased from \$A10,000 to \$A20,000. In October the banking legislation was amended, reducing from 65 percent to 60 percent the proportion of depositors' balances that savings banks subject to the Banking Act (i.e. those savings banks which operate interstate) are required to hold in prescribed liquid assets and public sector securities. And in December the trading bank interest bearing term deposit facilities were extended from two to four years.

The year 1971-72 saw a substantial easing of restrictions over the banking system. In December 1971, the Statutory Reserve Deposit Accounts were reduced from 8.9 percent to 7.1 percent, with part of the release of funds being used to supplement the special Term and Farm Development Funds. At the same time, the Reserve Bank announced that bank lending was no longer required to remain under official control. Banks were thus free to meet the requirements of their customers, subject to their normal commercial judgments and to their individual liquidity positions. Equally significantly, as from February 1972, the maximum overdraft interest rate applies only to loans drawn under limits of less than $A50,000. As regards deposit facilities, banks were given greater freedom for dealings in larger amounts. Subject only to a maximum interest rate, rates of interest over the whole range of interest bearing term deposit facilities in excess of $A50,000 are now a matter for negotiation between the banks and their customers.

<u>Diversification Through Affiliates</u>

The first significant departure from commercial banking (i.e. the granting of highly liquid loans for short-term productive purposes) in Australia was the banks' participation in hire-purchase business. The activities of hire purchase companies, or finance companies as they are now called, had been largely confined until the early 1950's to providing installment credit for durable consumer goods, particularly automobiles. In addition, these firms had looked to the banks to supply a relatively important proportion of their funds. Their rapid growth, however, dates from the central bank's decision that trading bank advances to this group should be restricted in the interests of controlling inflationary pressure. The finance companies were thus forced to seek fixed-interest funds from the general public in the form of debentures and convertible notes. In the event, they successfully tapped the capital market, and were soon broadening their activities into newer fields of financial operations. Faced with the unhappy prospect of being "dealt out" of a rapidly growing field of activity, the banks, with the acquiescence of the central bank, took positive action. Between 1953 and 1957 all the major trading banks entered into direct association with a finance institution, by equity participation or, in one case, by establishing a wholly-owned subsidiary. More recently, several banks have moved to acquire greater equity holdings in their finance company affiliates; there are now three major trading banks with wholly-owned subsidiaries operating in this field of finance. It is worthy of note that, in Canada some 40 percent of all consumer credit outstanding is supplied directly by the chartered banks.

The second major extension of trading bank activities was into the savings bank field. This move was prompted by the rapid growth of the Commonwealth Trading Bank which "undoubtedly derived benefit in its operating costs and in competing for general banking business from sharing the use of branches and staff with the Commonwealth Savings Bank and operating commercial and savings business side by side".[4] The trading banks thus realized the need to offer comparable services to the C.T.B./C.S.B. operation and in January 1956, two of them formed subsidiary companies to operate purely as savings banks. By 1962, all of the major trading banks had established similar subsidiaries. Administratively it might have been simpler to have created a new type of savings deposit within the existing structure of the trading banks, but this would have brought such savings deposits within the ambit of the SRD and LGS requirements and other official controls. On the other hand, the new savings banks were obliged to conform to an investment and lending pattern identical to that practised by the Commonwealth Savings Bank. This was the so-called 70/30 rule, which is now the 60/40 rule. Whether the existing ratio of prescribed assets to housing loans is reasonable in present circumstances may be debatable; but it is plain that the savings bank subsidiaries was competed very vigorously with the other savings intermediaries.

The latest major move by the trading banks has been into the so-called "merchant banking" scene. As noted earlier, official controls over the banking sector led to a whole new range of non-bank financial intermediaries. These first took the form of stockbrokers, finance companies, money market operators (both official and unofficial), building societies

[4] R.F. Hoder, "Australia", <u>Commonwealth Banking Systems</u>, ed. W.F. Crick, Clarendon Press, Oxford, 1965, p. 61.

and credit unions and, more recently, foreign financial institutions. The competitive pressures caused by this development were accentuated by the major discoveries of oil, nickel and other minerals in the period of the mid to late 1960's, with their substantial and growing demands for funds. The reaction of the trading banks to this new set of circumstances was to join with leading overseas financial institutions in the formation of merchant banking groups. These new groups attempt to provide a full range of services, complete with international facilities. For example, the Investment and Merchant Finance Corp. (which includes the Royal Bank of Canada, National Bank of Detroit, Anglo-American Corp. of South Africa along with its Australian partners) manages portfolios and acts as an investment counselor. It operates in the short-term money market, raises its own funds in the capital market and lends directly. It arranges acquisitions, mergers, takeovers, and provides management services. It builds, rents, manages property and brings property developers and investors together. It even has a travel agency. In short, Australian banks, through their merchant bank affiliates are now offering a more complete and more broadly-based financial service.

Another diversification move has been into the factoring business. In recent years, several trading banks have taken an equity interest in factoring companies. Basically, factoring involves the purchase of accounts receivable without recourse against the sellers and with notification of debtors. The three main elements of a factoring services include: short-term finance; a sales accounting and collection system; and credit cover or insurance.

Apart from their participation in affiliated companies, the banks have also extended their range of direct services in recent years. These new facilities include comprehensive travel services, portfolio management, unit trusts and superannuation funds and business advisory services.

Foreign Banks

Not since 1942 has a foreign bank been authorized to open a full branch in Australia. As already mentioned, only two foreign banks operate to a limited extent in Sydney and Melbourne. In the past ten years many foreign banks have tried to obtain a banking licence but without success. One of the main reasons cited for this nationalistic position is that:

> "..any opening up of the very lucrative foreign exchange market which is at present responsible for, according to some sources, between 20 and 25 percent of total Australian trading bank profits, would have widespread social consequences. Australians argue that these profits act as a cushion for any losses they may incur in manning a network which, because of its extent and the smallness of some of its branches may not be entirely profitable."[5]

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[5] Stuart Arnold "Banking in Australia: Tradition and Innovation", Journal of the Institute of Bankers, London, December 1971, p. 422.

Officially, banking has long been designated a prohibited area on the score of not wishing to see the investment of Australians' savings under the control of foreign interests. On the other hand, the mining boom at the end of the 1960's really emphasized the potential and scope for foreign-based intermediaries. It is against this background that foreign banking is developing in Australia.

Although barred from setting up direct branches in Australia, foreign banks are permitted to open representative offices or take shareholdings in non-bank financial institutions. This freedom enabled foreign banks to move into most financial fields with the exception of foreign exchange and chequing accounts. In fact there are now some 90 foreign banks operating in Australia; these include the thirty largest in the world.

These foreign banks are bringing to Australia a wide range of sophisticated financial services covering portfolio and property management, money market operations, corporate counselling and financing facilities. Furthermore, links with the world's leading banks not only open the international capital markets to Australian interests but also provide them with the professional contacts so essential for their international clients.

In this latter connection, it should be mentioned that the outward spread of Australian banks' interests is also evident in the establishment of representative offices in some major overseas centres (i.e. Tokyo, Hong Kong, Singapore). Of course, the major trading banks have long been established in the City of London.

Government Financial Institutions

As noted earlier, the Commonwealth Bank was established in 1911 as a federal government savings and trading bank. Its creation was politically inspired by the Labour Party to "curb the money power of the existing banks by providing government competition".[6] While it grew rapidly from the outset, it always avoided aggressive competition with the commercial banks, despite its complete freedom from taxation. Indeed, it was this conservative attitude that led to the inclusion in legislation in 1945 of the formal duty of the General Banking Division to develop and expand its business.

The 1945 Act also created an Industrial Finance Department to provide funds for the establishment and development of industrial undertakings, particularly small ventures. The Department also transacted certain types of hire purchase and this service provided a competitive spur to the private trading banks. In this context, it should be remembered that all the other major trading banks forged direct links with hire-purchase business between 1953 and 1957. In addition, we should bear in mind that the establishment of savings bank subsidiaries was inspired by, "more than anything else, the competition banks faced from the rapidly growing Commonwealth Trading Bank".[7]

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[6] Cited by Holder, loc. cit., p. 58.

[7] Ibid, p. 61.

In 1953 the General Banking Division of the Commonwealth Bank became a separate legal entity known as the Commonwealth Trading Bank. Finally, in 1959 this bank became part of a new Commonwealth Banking Corporation, of which the other components are the already existing Commonwealth Savings Bank (it became a body corporate in 1927) and a new Commonwealth Development Bank combining the mortgage banking and industrial finance departments of the former Commonwealth Bank of Australia.

To sum up, the Commonwealth Banking Corporation is the nation's biggest banking group. It holds over 30 percent of deposits with all banks in Australia. The Commonwealth Savings Bank is Australia's largest institutional lender for housing, approving 35 percent of the total housing loans of all savings banks during 1972, and 24 percent of housing loans by savings and trading banks. The Commonwealth Development Bank has provided more that $A950 million for primary and secondary industry since its inception. The Commonwealth Trading Bank is an active competitive commercial bank.

Three state governments have set up trading banks mainly to promote land settlement and rural development by providing long-term loans on conditions beyond the scope of ordinary banking concerns. The funds for these three banks are provided mainly by state-guaranteed debentures, by government loans, and to a small extent by deposits from the general public. These banks also administer a number of government lending schemes.

In recent years they have developed their lending for city house purchase and have extended their activities in the general banking field. In sum, their share in the banking system has grown proportionately, and in their respective states they offer active, but not serious, competition to the other banks for deposit funds.

The three state savings banks supply a high level of competition for consumer savings and provide substantial support for public works, utilities and housing in their own states.

Australian Resources Development Bank

The principal objectives of the Australian Resources Development Bank, which opened to the public for business in March, 1968, are:

"1. To provide finance for the development of Australia's natural resources, especially minerals, oil and gas. Development includes the extraction of raw materials, processing them into marketable forms, their subsequent transport to markets, and providing essential ancillary services.

2. To thereby accelerate economic development of Australian enterprises, particularly but not exclusively, those capable of providing export earnings or import savings.

3. To facilitate greater Australian ownership and control of natural resources through the provision of large scale term loan funds at reasonable rates of interest to projects with Australian involvement. The Bank will provide loan funds either direct to a borrower or by refinancing loans made by participating banks. The Bank will also provide equity capital, loan capital, or a combination of both."[8]

Capital Structure: As already indicated the Resources Bank is owned jointly by the seven major trading banks with support from the central bank and two state trading banks in the form of loan capital. The trading banks and central bank also support the Bank's capital base by way of subordinated loans on the basis of 60 percent from the commercial banks and 40 percent from the central bank to assist the Bank's operations in its initial years.

The authorized capital of the Resources Bank consists of 10,000 shares of $A1,000 each; of these, 3,000 shares have been issued and are fully paid, being subscribed in approximately equal parts by the seven shareholding banks.

Long-term loan capital is also provided by other participating banks: $A2.1 million by the Reserve Bank of Australia; $A100,000 by the Rural Bank of New South Wales; and

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[8]Australian Resources Development Bank, Annual Report, September 30, 1972, p.3.

$A50,000 by The Rural and Industries Bank of Western Australia.

The shareholding banks and the central bank have also supplied a total of $A47.25 million in subordinated loan funds. These loans are subordinate in right of repayment to deposits and other funds lodged with the Resources Bank.

The Bank's General Reserves stood at $A1.5 million at September 30, 1972 and a further $A1.3 million was held in reserve against fluctuations in overseas currencies at that date.

A net profit of $A2,225,167, after provision for income tax, was achieved in the year ended September 30, 1972. Out of this profit, a dividend of 20 percent requiring $A600,000 was paid. This was the second year in the Bank's first five years in which a dividend was paid.

On September 30, 1972 the total of the Bank's capital funds base, consisting of share and loan capital, accumulated reserves and subordinated loans was $A55.9 million.

Other Sources of Funds: Deposit facilities offered by the Resources Bank in Australia consist of Transferable Deposits and Term Deposits, which provide for medium-term invesment in the four to ten year range and Negotiable Certificates of Deposit issued for periods of from three to six months. At September 30, 1972, total Australian deposits amounted to $A256 million.

The Bank's first overseas deposits were accepted in December, 1969. Such deposits amounted to $A40 million at September 30 in 1970, rose rapidly to $A74 million in 1971, and dropped sharply to $A35 million in 1972. Clearly the Bank has ready access to large-scale overseas deposits as and when these are needed for its operations.

From time to time, the Bank makes use of short-term bridging loan facilities provided by the participating trading banks and the central bank. These facilities assist the Bank in financing temporary liquidity fluctuations which do not warrant the mobilization of longer-term funds.

Loans: Over the first five years the Bank has been in existence it approved loans for projects in all parts of Australia totalling $A409 million. At September 30, 1972, total loans outstanding amounted to $A337 million.

Projects eligible for the Bank's support must have a significant degree of Australian ownership. Finance may even be provided for projects with a relatively small Australian interest if this assists the retention or enlargement of the existing Australian participation. Another essential feature of the Bank's loan requirements is that projects are developing natural resources. Capital expenditure on ancillary facilities essential to the undertaking is also covered by the Bank's loans.

Loans are generally provided in the form of term loans for periods ranging from five to ten years calculated from the end of the drawdown of the loan. Progressive drawings of loans are permitted in accordance with borrowers' requirements while repayments are usually made on a periodical basis during the term of the loan.

During 1972, the Bank mainly refinanced individual and consortium trading bank loans. It also made a number of direct loans, including participations as a member of bank consortia, and as a consortium leader.

Social Responsibility

In recent years there has been a growing demand for social accountability in business. Indeed, it has become increasingly recognized that "it is fundamentally wrong that a company should be legally responsible only to its shareholders, and not to its employees, its customers and the community at large, except insofar as specific legislation might cover these groups."[9] As banker G. Arnold Hart has perceptively commented: "self-interest alone demands that business play its full role in ensuring that the healthy development of the community as a whole is not inhibited by failure or decay in any of its parts".[10] All this having been said, however, it remains a fact that social responsibility has a long way to go in the western type of industrial economy.

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[9] Hermes, "Social Responsibility", Journal of the Institute of Bankers, London, April 1973, p. 117.

[10] Business Review, Bank of Montreal, October 29, 1969, pp. 1-5.

It should be emphasized, however, that the annual reports of Australian banks indicate a degree of awareness about the responsibility of the business community to participate in the solution of critical local and national problems - as well as a willingness to make the effort - that is almost totally absent from the published reports of banks in the United Kingdom, West Germany and Canada. The Bank of New South Wales, for instance, has told its shareholders that:

> "Under modern political and social conditions, the Bank believes that it is not enough that it discharges its duties to its customers, proprietors and staff by providing the services needed and by operating efficiently and profitably. It accepts social responsibilities as well as business obligations. The Bank, its directors, and staff are therefore concerned about community problems and take positive steps to contribute to their solution and to the enrichment of the way of life in the countries served."[11]

Some of the main areas of participation by the "Wales" in 1972 and 1973 were:

1. Trade apprenticeship awards.
2. Community service awards in the fields of commercial radio and suburban newspapers.

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[11] Bank of New South Wales, Annual Report, September 30, 1972, p. 30.

3. Support to several cultural organizations (e.g. Arts Council of Australia).
4. Co-sponsored several environmental promotions (e.g. Operational Earth Day).
5. Support for several instructional films.
6. Donated equipment to several hospitals.
7. Support to agricultural shows and Young Farmers Movements.
8. Support to several youth organizations.
9. Sponsors a helicopter rescue service which covers 36 beaches in the Sydney metropolitan area.
10. Special grant of $A20,000 to complete the "National Photographic Index of Australian Birds".
11. Donated four pulse indicators to ambulance services.

The Commonwealth Banking Corporation met its "corporate citizenship obligations" in 1972 in the following ways:

> "Financial and other help has been given for medical and scientific research, education and training and other socially desirable activities. Donations have been made for research into heart, cancer and other diseases; to aid the disabled and destitute; to youth movements; to help send Australian representa-

tives to the Olympic Games in Munich; to universities and to management education; for flora and fauna protection and to victims of natural disasters.

Research grants have also been made through the Commonwealth Development Bank to primary and secondary industry. These have been for the improvement of production techniques, eradication or control of diseases affecting livestock and crops and to help technical and specialist education.

The Corporation continues to maintain close links with universities, the Australian Administrative Staff College, the Bankers Administrative Staff College, the Australian Institutes of Management and other educational bodies".[12]

A glance at the annual reports of other Australian banks show a similar involvement in community affairs. In short, it appears that Australian banks consider it a duty to devote a portion of their profits to community purposes, both local and national

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[12] Commonwealth Banking Corporation, Annual Report, 1972, p. 13.

The Impact of Direct Controls

In April 1971, the Governor of the Federal Reserve Bank of Australia, Mr. J.G. Phillips gave an extensive outline of thought and policy within his bank.[13] Concerning the conduct of monetary policy, the Governor said:

> "In recent years the Bank has tried to move towards reducing its reliance on direct controls over banks, and towards action which operates over a wider field. While direct controls can be a useful help to policy in the short run, they cannot be used continuously in the longer run without support from appropriate marked oriented policies; as time goes on the market tends to find ways around a direct control. In Australia, direct controls tend to be almost always directed at banks....their growth in the long run depends upon their ability to offer services that other do not or cannot offer as efficiently".

Put another way, by the mid-1960's the monetary authorities in Australia had come to recognize the weaknesses arising from a policy which concentrated on one sector of the financial market only - the trading and savings banks- and which gave rise to distortions in the financial system with an incentive to the expansion of credit which was outside the

[13] 1971 Mills Memorial Lecture, Sydney, Australia

banks, and outside the direct control of the authorities. Therefore, as already mentioned, important variations in Australian banking policy and practices were introduced in the late 1960's and early 1970's.

By these measures the authorities have gone a long way towards permitting the banks to play a more active part in the expansion of the Australian economy. But a competitive and adaptable banking system also depends on the attitudes and initiative of the institutions themselves, and these have not changed all that much since the mid-1960's.

Commenting on monetary policy over the decades from 1945-65, one well-known Australian economist has said:

> "I do not think that any banking system in the democratic world has accepted with more sincerity than our own the direct controls imposed upon it from time to time, nor acted with greater alacrity in executing the many requests of the authorities which are inseparable from monetary management."[14]

And therein lies the rub. Ever since the mid-1940's Australian financial institutions have been inhibited from developing their potentialities and opportunities by restrictions on interest rates, credit levels and the use of

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[14] G.R. Mountain, "The Monetary Scene Today", Second Conference of Economists, Sydney, August 1971, p. 20.

their funds. At the same time, they have been sheltered from the outside world by paternalistic government actions. As a result, they have not developed those traits of vigorous innovation and creative competition which are so essential if financial institutions are to respond readily to changing public preferences and needs. Thus, if Australian banks are not to become excessively bound by tradition, the monetary authorities must create an environment within which different classes of financial institutions can compete with each other on an equitable and open basis. Otherwise the financial system will frustrate the authorities principal aim of maximizing economic and social welfare.

Conclusions

The period since the mid-1960's constitutes an important landmark in the development of Australian banking. In an endeavour to counteract the slow growth of the banking system, and the declining area of central bank control, the monetary authorities moved towards accepting some long-advocated freedoms for the banks and a more flexible use of the interest rate weapon. In consequence, there have been some fundamental alterations in banking policy and practices. For one thing, all the major trading banks are moving rapidly into term lending, personal loans, bridging finance, equipment leasing, mutual funds, portfolio management, travel facilities, and international services (either through direct representation or through banking groups). All this shows a trend towards 'one-stop' banking.

The success of the money market helped the Reserve Bank move away from direct controls over the trading banks, culminating in the very easy policies of 1971-72. As a result, these banks can now respond more quickly to market and seasonal pressures.

As in other advanced countries, there has been a blurring between the traditional banking institutions and many of the non-bank intermediaries. This raises complex and important issues regarding equity and efficiency. The federal government has therefore asked the Treasury and the Reserve Bank to prepare a study on the activities of the non-bank intermediaries.

It is estimated that a remarkable 300 foreign enterprises, almost one-third of them banks, are currently investing in Australia's major financial institutions. The federal government is carefully examining this development in its review of policy on overseas ownership and control of Australian enterprises generally. Pending the outcome of the review, it has indicated that additional investment from overseas for the establishment of new near-banks is generally not favoured. Be that as it may, it is clear that the new foreign banks have instilled a greater element of competition into certain specialized areas of the banking scene and have helped to reduce the parochialism and isolation of the capital markets.

In all probability, a reduction in the present very high government security investment requirements would give the private savings banks greater scope to balance their housing loan and investment portfolios according to yields available on them.

While federal banking concerns offer considerable competition to the other trading and savings banks, state banks have had relatively little impact on the banking environment. Thus, it cannot be taken for granted that government ownership of banks promotes competition within the banking industry or improves the quality of banking service. It should be added, however, that the new Labour government intends to make the Commonwealth Trading Bank something of a new role for that venerable institution.

It is increasingly recognized that credit control is now more effective and flexible, particularly in contrast to the complex and confusing procedures that pertained prior to 1972-73.

It also appears that the Australian Resources Development Bank has now firmly established itself in the Australian and overseas capital markets, and that it could usefully be copied in Canada. In this connection, it should be pointed out that some experts have estimated that Canada's total money requirements for the energy industries could reach between $120 and $130 billion over the next 15 years.

A final point should be made. Australian banks seem to be more conscious of their social responsibilities than their counterparts elsewhere.

ADDENDUM : AUSTRALIA

Although the general performance of the Australian economy over the 1974-75 interval was the worst in the post-war period, increases in banking figures over the same period were large. For example, the aggregate deposits of the major trading banks totalled to $A 14.5 billion in September 1975, compared with $A 11 billion two years before. Loans and advances rose from around $A 7 billion in 1973 to $A 10.1 billion in 1975. Much of the increase in new lending occurred through the growing use of bill finance. And the proportion of deposit funds bearing interest continued its increase to 63 percent in September 1975.

In the late months of 1974, the banks were encouraged to expand their lending and their resources were augmented by accelerated government spending and by releases from special reserve deposit accounts. But in March 1975, the banks were asked to observe a lending ceiling aimed at supporting a recovery of economic activity without adding to existing inflationary pressure.

Savings bank deposits have also expanded at a high rate in recent years, and so have their housing loans which now represent some 37 percent of their deposit funds.

Another feature of the Australian banking system since 1973 has been the rapid growth of personal loans, and the introduction of an all-purpose credit card - Bankcard. The banks have also extended the range of their corporate services and expanded their network of branches and subsidiary companies both at home and abroad.

The Australian Resources Development Bank Limited continues to make a valuable contribution to Australian participation in major resource development projects. And for the year ended September 30, 1975, its loan approvals totalled $A 212 million.

Throughout 1974 and 1975 Australian banks continued to work hard at being "good citizens". That is to say, they encouraged their staff to give time to public service and local charities, contributed to the arts and cultural, educational and sports activities, and provided financial assistance to disadvantaged persons. But in the nature of things, these activities, as positive as they are, are not good enough. Given their great size and power, the banks must do more. Specifically, they must begin to participate in the solution of critical local and national problems - inflation, unemployment, deteriorating productivity, development of backward and distressed regions, urban blight, the protection of the physical environment, and the like. While this is easy to say and difficult to accomplish, it is not impossible. Much could be done, for example, by giving sufficient regard to the consequences of mergers and takeovers, or by actively seeking out the medium sized business firms which need capital for the development of new products.

Some General Comments

This paper has sought to trace monetary and banking developments in Britain, West Germany and Australia during the 1960's and the early 1970's and to highlight aspects involving policy considerations for the relevant monetary authorities that have arisen during this period. In the event, this experience has brought out six lessons. First, quantitative and qualitative controls on bank lending have at best, only partly achieved their desired objectives, and this at some cost in terms of the efficiency of financial markets. Second, the recent shift in emphasis in monetary policy towards increased reliance on interest rate variations has made monetary policy more pervasive and thus more effective, generally with less distorting effects on resource use. Third, the move towards increased competition in the three countries has promoted the concept of the multi-purpose bank, able to offer a customer an integrated package of services suited to his particular needs and all housed within one point of supply. Fourth, the need to develop and improve a servicing capacity for their customers' overseas requirements are dictating new methods and new forms of international banking organization. Thus it would appear that all the larger banks in the Western world will ultimately have to go global in some form to stay competitive. Fifth, it is likely that the needs of an advanced industrial country requires the close involvement of banks in industry. Sixth, it has become increasingly apparent that there must be a more direct involvement by banks in community affairs. Otherwise they will become increasingly subject to social control.

What all this strongly suggests is that the trend towards the giant universal integrated multinational bank is irreversible and beneficial.