Book Review

Expanding Frontiers for Banking

Banking in the British Commonwealth. Edited by R S Sayers Pp vii + 486. Price in UK only, 355 net. Oxford University Press.

THIS collection of essays on the banking systems of the Commonwealth is a welcome addition to the all too sparse literature on comparative banking ft is an uptodate and more comprehensive supplement to Plumptre's standard work on Central Banking in the British Dominions. Most of the contributors have been associated with Professor Sayers,, either as colleagues or as students at the London School of Economics, and in addition, have the advantage of having practical contacts with the banking systems of their respective areas.

Professor Savers contributes a brief hut incisive introduction in which he traces out tire essential features of banking evolution in the Commonwealth and indicates the possibilities of future development. Of particular interest are his remarks on central banking in undeveloped systems. He emphasises the close interdependence[4] of the two aspects of a bankers' business as a provider' of means of payment and as a lender and borrower. According to him

> The progress of a bank depends, more than anything else, on the relations developed between borrower and lender—whether the bank is the borrower and the customer the lender, or *rice versa.* Banking is thus conditioned by the general economic structure, especially in the readiness with which property, in goods, land, and other assets, lends itself to the creation of security for loans ".

Emphasising the need to adapt central banking techniques to the requirements of the respective economies. Professor Sayers says

> "A close banker-customer relationship continues almost everywhere in the Commonwealth to condition the volume of earning assets, and while this is so, the strength of central banking control of commercial banks has to depend upon harmonious direct contacts rather than upon an impersonal wielding of conventional weapons".

This theme is elaborated in some of the subsequent contributions.

All the essays in the present volume trace the rise of central and commercial banking in the Dominions and the colonies against the background of their respective economies. In spite of the diversity of historical and institutional factors, it. is possible to generalise to a limited extent about the necessary pre-conditions for the successlul operation of a central bank. These are succinctly summarised by Mr Dorranee in his essay on the Bank of Canada, They are

(1) reasonable stability of commercial bank ratios between some asset or assets and the volume of deposit and note liabilities;

(2) the central bank by its own action can after the volume of specific assets used in maintaining this ratio; and

(3) an adequate capital market based on
   - (*a*) relatively constant flow of in vesta ble funds of domestic origin,
   - *(b)* large business in existing securities,
   - (c) sufficient volume of short-term lending and borrowing, and
   - *(d)* well established institutions to impart stability in times of crisis.

Though all the contributors have taken due note of these factors, they have not given sufficiently detailed analysis of the respective capital markets. This could have been done by compressing the more familiar material easily available elsewhere. In particular an analysis of institutional inadequacies of capital markets would have been very useful. The Commonwealth countries have their own peculiar "Macmillan Gap' or in fact a variety of them. Mr Day's essay on the South African Reserve Bank refers to the organisation and role of the National Finance Corporation of South Africa, which, among other objective's, aims at the promotion of an active short-term money market in South Africa. One also misses an adequate analysis of the effects of price-volatility on the monetary and banking systems of under-developed areas in the Commonwealth. The existence of a lender of last resort in the form of a central bank would, of course, act as a stabiliser and discourage development of speculative crises, particularly in economies where elasticities of expectations are high as in the under-developed areas. But the existence[1] of a central bank is not a sufficient condition of monetary stability. It is interesting to note Professor Silvers' observations on the temptations of deficit-finance in capital-hungry under-developed territories. "Here the central bankers must be ready to light hard for the distinction between capital and money. From this point of view a little of the old-fashioned independence, at any rate in expression of opinions, can be of real importance. The first Annual Report of Ceylon's new central bank provides an interesting precedent." It is of course, arguable whether a newly-founded central bank will have the necessary prestige and resources to attain such a position.

The articles on the monetary and banking systems of New Zealand (by Mr Sirukin), Ceylon (by Mr Gunasekara), and the Colonial Empire (by Mr Newlyn), will be of particular interest to those dealing with problems of dependent and under-developed economies. "But they do not provide enough material for answering the question as to how far a central bank is desirable or feasible in colonial countries and in what way it represents an improvement on the older systems of automatic and non-discretionary currency boards. Mr Newlyn's otherwise interesting theoretical analysis of the nature of the money supply in colonial countries does not deal with the effects of these automatic currency systems on the rate of economic progress in these countries. We are not told whether the operations of these boards affect the direction and pace of domestic economic development; whether the size and/or the composition of the currency reserves or the mechanics of the monetary system impose any ' real ' sacrifice on the inhabitants.

The principal advantage in favour of the hundred per cent backing for colonial currencies is the maintenance of the stability and the integrity of the local standarc! of value— a vital consideration where money is not yet wholly familiar to all sectors of the economy. But there is at least a case for a limited fiduciary issue in respect of that component of the outstanding currency which would under no circumstances be redeemed, duly reinforced by safeguards against over-issue. Of course, the problem of establishing a central bank with severance of the link between local currency and the volume of foreign exchange reserves is a much wider one.

Mr Paul Bareu's essay on 'The Sterling Area' comments upon the monetary setting in which the Commonwealth countries have to operate. He outlines the factors that have led to the emergence of sterling as an international store of value and medium of exchange. But he overlooks, in common with many other commentators on the Sterling Area, that for a currency to be truly international it has to avoid the extremes of being too scarce in supply, as is the dollar today, or of being too abundant as present-day sterling threatens to be. The delicate equilibrium of a currency area is based on the proper volume of the parent currency in relation to others. Fundamentally, the strength of a currency derives from the underlying real forces.

The present volume is comprehensive, uptodate and accurate, and will long continue to be a standard work on the subject. One hopes that, the editor and his associate's will follow it up with a companion volume on the more important non-Commonwealth countries.