

THE BANKING LEGISLATION

THE banking legislation introduced to Parliament by the Prime Minister on the 19th February, represents another episode in the controversial story of the evolution of the structure of the Commonwealth Bank and of the relationships between the Central Bank and the trading banks—a story that may not yet be complete. To appreciate the meaning of the legislation it must be viewed in the perspective of recent history.

Since the early years of World War II, the legal changes have been bewilderingly rapid. The impact of the war brought about far-reaching alterations to Australian banking methods. The need for controlling the inflationary potential of war finance and of directing financial resources into channels concerned with the effective prosecution of the war led the Commonwealth Government to invest the Central Bank (by means of National Security Regulations) with extensive powers of control over trading bank finances. *The most important of these powers was the system of Special Accounts introduced in 1941.* This system provided that increases in the assets of the trading banks above a stipulated base date would be deposited with the Commonwealth Bank. These assets could not be used by the trading banks for expanding their advances and thus adding to the inevitable inflationary pressure associated with huge government spending for war purposes. Other important features of the regulations were the direct control by the Central Bank over the purposes for which trading bank advances could be made and over all foreign exchange transactions, and the strict limitation of the extent of trading bank investments in government securities.

In August, 1945, the Labour Government introduced the 1945 Banking Act to give more or less permanent legislative validity to the war-time banking controls. For example, in the case of the Special Accounts, the Act empowered the Commonwealth Bank to require a trading bank to lodge to Special Account the whole of the increase in its assets since the 28th August, 1945. It also required the trading banks to lodge in Special Account the amount standing to the credit of that account at the time of the commencement of the Act.

At the same time the Government introduced the Commonwealth Bank Act 1945 which involved radical changes in the structure of the Central Bank itself. The Bank Board established in 1924 was abolished, the Bank was placed under the sole immediate authority of the Governor of the Bank, and the Governor himself was made subject to the Commonwealth Treasurer in the event of a difference of opinion on policy. Both the Acts were hotly contested by the Opposition parties and the then leader of the Opposition, Mr. R. G. Menzies, pledged that on return to office he would restore board control of the Commonwealth Bank, free from political interference. *This he proceeded to do in the Commonwealth Bank Act of 1951.*

BUT, in the meantime, the historic attempt to nationalise the trading banks had been made by the Chifley Government through the Banking Act of 1947 amid circumstances of violent controversy. The Constitution saved the banks. The Act was declared invalid in August, 1948, and the Menzies Government was returned to office in December, 1949, a result undoubtedly strongly influenced by the public's fear and distaste of a nationalised banking system.

The verdict of the Privy Council and the restoration of the principle of board control of the Commonwealth Bank did not, however, set at rest the fears of financial institutions and of important sections of the public regarding the framework of banking legislation. It was still felt that certain provisions, especially those relating to the Special Accounts System, constituted a severe encroachment on the principle of free enterprise in the banking field and went far further than was necessary to secure effective control of monetary policy by the Commonwealth Bank. There was the danger that the legislation, so far as the control provisions were concerned and also that relating to the structure of the Commonwealth Bank, could be used to promote and to expand the trading bank section of the Central Bank at the expense of the private banks, and in the long term to bring about virtual nationalisation of the banking system. *It was pointed out that the Commonwealth Bank was able to compete for ordinary banking business under conditions grossly unfair to the private*

banks since the trading section of the Commonwealth Bank was not subject to the same Central Bank controls, such as the Special Accounts System, as applied to the private banks.

* * * *

THE new legislation attempts to remove the grounds of these criticisms and at the same time to maintain effective control of national monetary policy through the Central Bank.

It consists of two Bills, one to amend the existing Commonwealth Bank Act; the other to amend the 1945 Banking Act. The main feature of the first is that it establishes the trading section of the Commonwealth Bank as a separate corporate entity (the Commonwealth Trading Bank of Australia) with its own management, subject, however, to the direction of the Board and Governor of the Commonwealth Bank. The present statutory obligation of the Commonwealth Bank to expand the business of the General Banking Division is retained, but applied to the new Commonwealth Trading Bank. However, the new bank is obliged to conform with the main control provisions applicable to the private banks; such as the lodgment to Special Account, advance policy, and so on.

In the new Banking Bill, the Special Accounts procedure for the quantitative control of bank trading is retained but defined limits are placed on the amounts which can be called up by the Central Bank—the maximum amount is placed at the balances in Special Account existing at October 10, 1952 (totalling £171 million) plus 75% of any increase in deposits from September, 1952. This contrasts with the existing provision whereby the banks can be required to lodge the whole of their increase in assets since the 28th August, 1945, in Special Account. This has meant that the banks have had hanging over their heads a virtual Sword of Damocles, in that at any time they have a huge uncalled liability (amounting at the time of writing to around £500,000,000), which could conceivably be used to their grave financial embarrassment should the Government or the Commonwealth Bank feel disposed to apply the law in arbitrary fashion. *This liability is specifically wiped out under the new legislation. The un-*

called liability of each bank would under the new Act be adjusted each year so as not to exceed 10% of its average deposits. There are other provisions designed to provide additional protection for the trading banks in the matter of their prospective liabilities on Special Account.

* * * *

WHAT can be said in praise or criticism of this legislation?

This is not the place to weigh minutely the merits and demerits of the various provisions it embodies. But a few general observations may be of interest.

The broad intention of the Bills is to give effective protection to the Trading Banks against arbitrary and hostile misuse of powers resident in the existing statutes, and at the same time to ensure that the Central Bank is maintained in a position where it is able to control monetary policy in the best national interest. It has been pointed out that it would be relatively simple for another Government to revert to the old arrangements, and that this might have been much more difficult had the General Banking Division of the Commonwealth Bank been established as an entirely separate institution outside the jurisdiction of the Board and Governor of the Central Bank.

A PART from that, there is strong precedent in the practice of other English-speaking nations for a central banking institution divorced entirely from any trading activities. This is the position in the United States, Canada, and New Zealand, while the Bank of England engages in trading activities only to a very limited extent. This practice has clear-cut technical and psychological advantages. It allows the Central Bank authorities to concentrate wholly on the all-important problems of central banking, free from other distractions. Moreover it is calculated to produce a degree of confidence and co-operation between the Central Bank and the private banks greater than that which is feasible where the Central Bank authorities are also concerned with the business of trading. Political and historical, as well as technical considerations, however must be brought into account. *Whether the*

present moment is politically expedient for such a major break with tradition is a matter on which opinions will differ. Certainly, eighteen months ago the Government might have felt more disposed to embark on the bolder course.

From the strict technical point of view the proposed Special Account procedure may also be open to criticism. For instance, it has been claimed that a general overall control of bank resources would be fairer and automatically more impartial in application than control on an individual bank basis. While the possibility of discrimination between different banks is retained in the new legislation, the legislation would nevertheless seem to make possible the treatment of all banks on a broadly uniform basis, and it is to be hoped that the Act will be administered with this in mind. The general form of control is customary in most other central banking systems. For instance, those of the United States, Canada, and New Zealand operate on the principle of compulsory minimum deposits (representing a defined percentage of total deposits common to each bank) lodged with the central institution. The Australian economy, however, is peculiarly subject to wide fluctuations because of its close dependence on a notoriously unstable export income, and a case might be made out for somewhat stronger methods of control.

* * * *

WHATEVER might be said in criticism, the new legislation represents a step in the right direction. Despite differences from time to time with the trading banks, the Commonwealth Bank appears to have applied the powers provided under the old legislation with reasonable moderation and fairness. *Nevertheless these powers are so wide as to be capable of serious abuse and misuse by a government hostile to the trading banks. There is, therefore, no good reason why they should be permitted to remain.* The new legislation is an honest, if not in every respect satisfactory, attempt to bring about (in the Prime Minister's words), "... a just and proper reconciliation between the powers and functions of the Commonwealth Bank and an appropriate measure of protection to the trading banks".