

MONETARY FUNCTIONS OF COMMERCIAL BANKS.

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The object of this paper is to attempt to elucidate briefly from a practical standpoint the significance of bank deposits and bank loans in the monetary system and to analyse the actual character of the processes which they involve. The task is being undertaken because it was felt by the Council of the Society that a paper on this subject and the discussion which it should provoke might help to clarify some of the confusion which has been evident in much of the popular discussion which has been taking place in this country on these topics for some time past. The facts of Irish banking will be regarded throughout as providing the real background upon which our conclusions are to be based.

It will be useful at the outset to give some figures indicating certain main trends in Irish banking. During the twenty years preceding the First World War the deposits of Irish banks rose steadily at the rate of about one million pounds a year reflecting a general advance in economic prosperity. Subsequent developments are shown in the following table where the figures relate to the close of each year mentioned :

TABLE I (£ MILLIONS.)

	1913	1921	1925	1933
(a) Bank Note circulation ..	8.1	19.1	15.3	8.9
(b) Deposits and Current Accounts	70.8	212.8	185.0	184.1
(c) Bills, Loans and Advances ..	48.6	102.1	101.8	82.3
(d) Investments	21.2	103.1	86.3	98.7

It will be noticed that the large increases of liabilities (a) and (b) between 1913 and 1921 reflect corresponding increases in the assets (c) and (d), but that on the assets side the main brunt of the increase is borne by item (d), that is chiefly British Government securities. The reason, of course, is that during the war period the Government, through its issue of currency notes and vast borrowing, was the dominant force in expanding bank deposits. Reference will be made later to the significance of this for the refutation of the notion that the banker creates his own deposits. The mere issue of British Government securities could not, however, of itself produce this increase of Irish bank deposits: the decisive fact was that during the period concerned the customers of Irish banks received large sums from Britain in payment for goods and services and used the sterling so acquired to establish deposits in our banks. It was these factors and not any arbitrary or magical book entries by Irish bankers that produced so remarkable a rise of Irish bank deposits during and immediately after the last war. The general level of Irish bank deposits so established was not materially altered until the advent of the present war.

The figures of Table I relate to the entire business, wherever situated, of the Irish banks and include the Belfast Banking Company Limited. The figures which follow in Table II relate only to business in Éire.

TABLE II (£ MILLIONS.)

	1933	1937	1939	1941
(a) Deposits and Current Accounts	123·8	117·0	119·3	139·2
(b) Bills, Loans and Advances ..	48·4	51·6	54·4	49·9
(c) Investments	5·6	7·2	8·4	11·0
(d) Net Sterling Assets	79·9	67·8	65·4	83·8

These figures are particularly illuminating on the question whether and, if so, how far in this country bankers create deposits by making loans and destroy deposits by reducing loans. Items (b) and (c) show an expansion between 1933 and 1939 of nearly £9 millions. This expansion of loan items is accompanied not by any increase of deposits but by a decline of £4½ millions in that item. Both the new loans and the fall of deposits are in fact reflected in a loss of sterling. Again the experience of the first two years of the present war shows that a reduction of £2 millions in the loan items has been attended by an increase of £20 millions in deposits, the explanation, of course, being that the extra deposits were created, as happened during the last war, by customers entrusting to the banking system the sterling acquired by their trade and other activities through the course of the Balance of Payments. The other activities in question have included considerable realisation of sterling investments by private owners. Thus both in peace time between 1933 and 1939 and in war time between 1939 and 1941 the movement of deposits has been contrary to that of the loan items.

Some objector may suggest that the result just indicated is misleading in the absence of an attempt to segregate the specific effect of loans from the effects of other contemporary transactions. He may say that increase or decrease of loans taken separately may have increased or decreased deposits but that this effect has been obscured by the cross influence of other factors. To this it must be answered that in the practical art of banking it is in fact impossible to trace precisely the ultimate effect on a bank of the particular loans which it makes and that the banker must be guided largely by the aggregate results disclosed by the changes in his balance sheet from time to time. Further, although the effect of particular transactions is not separately traceable, it is possible to gauge the tendency of broad categories of transactions. For example, long-term lending to the Government and other public authorities especially for purposes of dead-weight debt, is much more likely in normal times to result in depletion of sterling than in increased deposits. Item (c) of Table II is an illustration of this and is all the more significant when it is explained that item (b) for 1939 includes £2·3 millions of Irish Government bills which were subsequently replaced by long-term Government securities forming part of the £11 millions shown for item (c) in 1941. When allowance is made for this special temporary factor it will be seen that item (b) shows only a very moderate variation over the whole period surveyed. Accordingly the broad conclusion is possible that over this period the loan policy of the banks *vis-a-vis* their ordinary customers has had a relatively trivial effect on the deposit position and that the transactions of the banks with the Government and public authorities

have tended on the whole to cause not an increase of deposits but a loss of sterling.

Loss of sterling by the banks need not necessarily entail, at least immediately, a loss of sterling to the country. It may happen, for instance, that some of the sterling lost by the banks passes to the Currency Commission to increase the issue of legal tender notes. In time, however, an inflationary increase of note issue would tend in normal conditions to create a situation unfavourable to the retention of sterling. It is interesting in this connection to compare with Table II the following figures showing the amount of legal tender notes outstanding at the end of the years mentioned against which the Currency Commission held equivalent amounts of sterling :

	£ millions		
1933..	7.8
1937	10.0
1939..	12.0
1941	18.2

Demand deposits as a form of money saving are not confined to the commercial banks. Amounts placed with the Post Office Savings Bank and in Savings Certificates have a growing importance and must be kept in mind as part of the forces closely affecting the operations of commercial banks. They are significant not alone as deposits but as providing a channel for credit creation outside the ambit of the commercial banking system.

The following figures indicate the position of the Post Office Savings Bank at the end of the years mentioned :

TABLE III (POST OFFICE SAVINGS BANK).

(£ MILLIONS.)

	1933	1937	1939	1941
(a) Deposits	4.8	8.5	10.7	14.2
(b) Irish Government Securities (nominal)	1.2	2.5	5.5	6.6
(c) British Government Securities (nominal)	4.5	7.0	5.3	5.7
(d) Cash	0.1	0.1	1.1	3.3

The following figures in respect of Savings Certificates relate to the 31st March following the end of the years mentioned :

TABLE IV (SAVINGS CERTIFICATES)

(£ MILLIONS.)

	1933	1937	1939	1941
(a) Deposits	9.6	10.8	11.0	11.5
(b) Irish Government Securities	0.05	0.05	0.05	0.05
(c) British Government Securities	1.5	2.9	3.2	3.1
(d) Cash	0.1	nil	0.1	0.5

Except in so far as covered by the specific securities of items (b) and (c) and by item (d) the whole of the deposits have been borrowed by the State on the general security of the Central Fund. It will be seen from Tables III and IV that in respect of deposits in the Post Office Savings Bank and in Savings Certificates credit created in favour of the Irish Government has risen from £9.2 millions in 1933 to £14.5 millions in 1941, that is a net growth of £5.3 millions. Between the same dates, as shown in Table II, net credit creation through the commercial banks in favour of ordinary customers, namely item (b), was only £1.5 millions, while in favour of the Government and other public authorities, item (c), it was £5.4 millions. Taking the State deposit institutions and the commercial banks together the net credit creation between 1933 and 1941 was £10.7 millions in favour of the Government and £1.5 millions in favour of ordinary bank customers. Even the latter figure presumably consists to some extent of State guaranteed Trade Loans. It is abundantly clear that in credit creation in this country between 1933 and 1941 the dominant role has been that of the Government. This conclusion would be reinforced if we took into account the transfer of bank deposits to the Government by the direct subscriptions of citizens towards issues of State loans.

With these facts as a background we may now proceed to analyse some of the notions commonly prevalent about the operation of commercial banks in the credit field. In doing so it is useful in the first place to bring to mind the plain and elementary point that in banking as elsewhere every credit has its debit and vice versa, or in other words that every actual banking transaction has both a credit and a debit aspect. To mention such an obvious matter might seem in this enlightened company to call for some apology were it not that it is constantly overlooked in monetary discussion. It is overlooked by some not in ignorance but in good faith because they take it for granted, sometimes too hopefully, that in their statements about debits the well-informed hearer will assume the requisite qualifications in respect of credits. It is more frequently ignored by less understanding persons who do not realise that in speaking of credits without advertence to debits and vice versa they are necessarily dealing with abstractions and cannot at best hope to express more than a half-truth.

The statement, for example, that the banker creates his own deposits cannot be a true and adequate assertion of any real fact any more than the allegation that after the departure of Lewis Carroll's cat the grin remained behind. In reality a debit without a credit is as meaningless as the grin without the cat and in discussion conducted on any real basis we can form no useful opinion about a debit *per se* until we incorporate it in a transaction which has also a credit aspect. In considering the practical operations of a bank we must keep our views directed steadily to transactions having the double aspect of credit and debit. This means that we are concerned all the time with persons acting at both sides of the transaction and not merely, for example, with the banker only who in any one transaction is only a part performer. What the banker does is limited and conditioned by what his customer does and it is unreal to attempt to assign a part to the banker which is independent of the part played by his customer, to say nothing of third parties.

Practical aspects of this point are further apparent when we consider its bearing on such a topic as credit control. Much popular discussion of this subject errs in assuming that to secure the objects in view it is only necessary to apply some regulatory action to the banker respect-

ing the giving or withholding of loans and the rates of interest applicable to them. It is not sufficiently realised that the attainment of sound objectives necessitates co-ordination of the matters mentioned with other elements of the banking system which the banker may be unable through any steps within his control to accommodate to the proposed regulatory action. A control that forced a banker to maintain a large volume of illiquid loans and professed to have no concern for the conduct of the bank's depositors would be worse than ineffective.

If, too, we wish to discuss agricultural credit it is not enough to be content with advocating extensive and generous credit for the farmer. To do this is mere beating of the air unless we also consider how far and in what circumstances we can advise the farmer to contract debt, what are the problems presented to the farmer and to the bank in the provision of suitable security and generally how the giving of credit is likely to result for all who are either directly or indirectly concerned.

Again it is necessary to have a true perception of what is meant when we speak of the "banking system." It is sometimes convenient to use the phrase to designate the general mechanism of bank deposits and loans in a country including the pattern of organisation through which they are operated. It would, however, be a serious error to suppose that the system even in this sense is something like a compact although complex machine such as a motor car which responds unflinching and uniformly to movements of controlling levers by a banker-driver. In its more real and practical sense the banking system is a somewhat loose aggregation of banking activities by a number of human participants among whom the banker and his customers are, no doubt, immediately the most important but in which decisive influences may also be exerted by third parties. When the banker makes a loan to his customer and the latter expends the proceeds in payments to a third party the behaviour of this third party in respect of the money he gets is of vital consequence for measuring the reaction of the loan transaction on the banking system, more particularly in so far as the banker in question is concerned.

This last expression has a special significance in directing attention to the fact that the banking system does not operate as an integrated whole. In this country, as in most others, it comprises a series of separately controlled banks of which each has to be administered as an independent unit. It follows that it is of slight interest to a banker to tell him that if he makes a loan he will create a deposit. He will naturally want to know if the deposit is likely to be found in his own bank and may be excused for being lukewarm if the prospect is that the deposit will go to a competitor within the banking system or perhaps to Timbuctoo. For the practical banker his own bank is a banking system in itself and he has a duty to keep it solvent and stable whatever his neighbours may be doing. No mere lending powers will enable him to function unless he gets deposits and for this he is dependent in the main on securing and holding the trust and goodwill of the public.

Again the several banks may be expected to differ appreciably in the character of their business and consequently in their respective roles in the monetary activities of the country. They will differ, for example, in their proportions of current to interest-bearing deposits, in the rate of turn over of current account balances, in the distribution of their business between rural and urban customers and in many other important respects. Differences in the character of liabilities will impose differing requirements in the constitution of assets. Thus we find, so to speak, a series of distinct banking systems presenting individual problems within the

general banking system of the country. Such a practical situation provides a warning against the undue simplification which seeks to treat commercial bankers as a closely bound class operating in monopolistic concert according to few simple uniform rules. This rigid conception of a class of bankers is as deceitful as that other abstraction the average man who is found more easily in textbooks than in the street.

We may come now to the important term "bank money." It is a well-known fact that in most modern countries a large and often predominant part of the money used in the settlement of the business dealings of the community is not the standard or legal tender currency but bank money. The phrase itself has different gradations of meaning and in common use bank money may take the form of either bank notes or cheques.

The bank note of the commercial bank has been of great historical importance and interest but it has now become an obsolescent form of currency being usually superseded by note issues of the State or the Central Bank. The remnants of it in this country will gradually disappear under the provisions of the Central Bank Act recently passed. In Table I of this paper the decline of item (a) between 1925 and 1933 already reflects the transition from the former elastic bank note issue to the restricted issue of consolidated bank notes under the Currency Act, 1927. In these circumstances extended references to problems of bank note issue would here be out of place but it may be of interest to mention one point that is very commonly not appreciated. It is often said that there is no difference between bank notes and deposits on current account in monetary significance. From the banker's standpoint there is at least one quite important difference by reason of the fact that where a loan is given in the form of the bank's own notes there is no immediate depletion of bank cash. Further so long as the notes remain in circulation the banker is relieved from any worry on the question whether the loan will yield him a deposit. He can look for a deposit only to his own customers but the bank note may be held freely by persons who deal either with other banks or no bank. It is hardly necessary to add that this convenience of the bank note to the banker has been known at times to make lending unduly easy and has in consequence had public disadvantages.

For practical purposes, therefore, bank money is now usually taken to mean deposits. This statement, however, is both too wide and too narrow for exact purposes. It is too wide because it embraces both interest-bearing or time deposits and deposits on current account: it is too narrow because it fails to cover the case of the overdraft.

A deposit at a bank whether at interest or on current account is doubtless money so far as the owner is concerned. But it is significant in monetary activity only to the extent to which it is or is likely to be actually used as money. The time deposit is accordingly best regarded as merely potential money. The degree of potentiality is a matter requiring attention on the part of the banker in considering the character of the protecting assets. In countries where statutory reserves are required to be held against deposits lower reserve requirements are commonly prescribed for time deposits than for current accounts. Yet it is a possible view that current accounts are better anchored at a bank than time deposits. The owners of the latter are more unhampered in removing them especially if the required notice is short or, as sometimes occurs, is easily waived: business customers, on the other hand, cannot conveniently dispense with their current accounts.

Current account balances are the effective form of bank money and the turn-over of them is of the highest significance in the monetary situation. With them must be included unused overdraft facilities which, though inevitably not apparent in a bank balance sheet, are a category of potential money with a high likelihood of early use. The cheques drawn against current accounts, black or red, are the measure of the banker's part in providing the community with money.

There are wide variations between one country and another in the ratio borne by the volume of current deposits to, on the one hand, the note issue and, on the other hand, the volume of time deposits. As regards the relation to note issue the member banks of the Federal Reserve system of the United States at the end of June, 1942, had thirty-seven billion dollars of demand or current deposits as compared with a total American paper currency of about twelve billion dollars and there were substantial further demand deposits in non-member banks. In England in October, 1942, the current accounts of the London Clearing Banks amounted to £2,261 millions as compared with about £850 millions note circulation of the Bank of England. In this country separate figures for time and current deposits of banks are not regularly published, but particulars were given for certain years in paragraph (160) of the Majority Report of the Banking Commission from which it appeared that at the end of 1936 current deposits were about £21.7 millions and time deposits about £90.5 millions exclusive of the accounts of the Government and local authorities. The note issue including consolidated bank notes is now about £30 millions, a figure which it may fairly be assumed cannot be far different from the present total of current deposits when allowance is made for the inclusion of public accounts and for probable expansion since 1936.

It is a matter of speculation whether the rate of turnover of notes or of current deposits is the greater, but it seems likely that at any rate in this country the notes are turned over faster. If so it seems reasonable to conclude that note currency plays at least as large a part as bank money and quite possibly a larger part in the adjustment of the financial transactions of the citizens of this country. It is far otherwise in England and the United States where bank money holds a great predominance.

Again in the proportions subsisting between current deposits and time deposits there are wide differences between the various national banking systems. This point is further obscured by differing investment conditions and by the extent to which separate savings banks not providing cheque accounts are operative. Ignoring these complications it may be sufficient to say here that in the case of the United States the previously mentioned figure of thirty-seven billion dollars for current accounts of member banks in June last compares with twelve billion dollars of time deposits, and that in the case of the London Clearing Banks the already cited figure of £2,261 millions for current accounts in October last compares with £1,163 millions for deposit accounts. In the commercial banking system of this country the position in this respect is more than reversed, as we have a greater preponderance of time deposits than that of current deposits in England and the United States.

The co-existence in our commercial banking system of a high volume of time deposits with a low volume of current deposits gives a special importance for Irish bankers to the problem of transfer from one category to the other. Such transfer is evidently a matter which is

largely outside any discretion of the banker, although it may have a decisive influence on the volume of effective bank money. The fact that the condition in question is associated with large holdings of sterling which can readily be used to augment cash reserves is perhaps the most outstanding and characteristic feature of our banking position. It is at the same time one which tends to make the way of inflation treacherously easy in this country, and consequently requires both the greatest vigilance on the part of the banker and intelligent understanding on the part of the public.

Of the various factors which help to determine the volume of bank money a leading part is usually assigned to cash reserves. It is for this reason that in a number of countries the statutory prescription of cash reserves has been adopted as a measure of credit control. It has, however, to be realised that there is much less uniformity and precision in the relationship between bank money and cash reserves than is sometimes supposed. Statutory ratios or, in their absence, conventional ratios vary from country to country and from time to time, and the term cash has not the same meaning everywhere. Even in England, where the nexus is at least in appearance most simple and constant, the proportion of 10 per cent. cash is measured against combined deposits of time and current categories, although, as we have seen, a shift between the two categories may alter fundamentally the true monetary character of the arrangement.

The closer the adherence to a fixed relationship between deposits and cash the less is the discretion of the banker in the determination of the amount of deposits. The Government or Central Bank which can regulate the volume of bank cash thereby indirectly regulates the volume of deposits based upon it. In countries where reserves are usually low the possibility of control is in consequence the greater. In this country, however, we are in a very elastic position as regards reserves in view of the large amount of external assets capable of ready conversion into cash.

It follows that for practical purposes the credit problem of this country does not encounter any serious difficulty on the score of reserves. It is fully in the power of the banking system to handle its side of the problem without embarrassment. Such difficulty as exists is to be found not on the supply or banking side but on the side of demand. These difficulties on the side of demand will not concern us here, as although they have an intimate bearing on the working of the commercial banks they have their roots elsewhere. Explanatory material is available in the Majority Report of the Banking Commission. That it is not the banker alone who regulates the volume of commercial credit can be seen also in foreign experience. In the United States the demand deposits of member banks of the Federal Reserve system more than doubled between 1933 and 1939 ; yet the loans for business purposes showed only a trifling increase notwithstanding large excess reserves and the attraction of low interest rates.

The character of the banker's loans has a close bearing on the amount of cash and second-line reserves that he must carry. The old belief in self-liquidating commercial loans of moderate duration remains inherently sound as the repayment of such loans ensures a steady inward stream of cash as the loans mature. Even loans of inferior intrinsic liquidity can still be made attractive to the banker if they are given the character of shiftability by the protection of adequate collateral in marketable securities. This expedient, however, fails if the banker proceeds too far with

investment either directly or by way of collateral in domestic Government securities where there is not an active market that can readily absorb such securities in amounts sufficiently large to meet banking requirements. In such circumstances Government securities of all but the shortest term are unsuitable to be held to any large extent by commercial banks on the broad ground that they do not afford that steady stream of repayments necessary for an institution carrying a large volume of demand liabilities that may at any time be translated into actual claims for cash. If banks are expected on occasion to take up a proportion of such securities it is in consequence very desirable that if the term is long there should at least be an adequate sinking fund.

It is not possible within the scope of this brief paper to pursue these topics through the numerous refinements of which they are capable and to examine the significance of such forces as changes in the velocity of circulation and other abnormal elements. A word is, however, necessary on the general need for distinguishing between the conduct of banking in more or less stable conditions and the functioning of the system at times of serious disequilibrium. In the normal conduct of banking there is at any stage a rough equilibrium to which the various persons and factors involved have more or less accommodated themselves, and this entails that there is a largely predictable ebb and flow in transactions between the banks and the public and between one bank and another within the country and between parties concerned in international transactions. It is against such a background that the banker usually operates and that the nature of his normal functions must be understood. Thus when the banker makes a loan it is not as an isolated transaction. He cannot pretend to follow its individual consequences, but has to fall back on what he can conveniently observe, namely, the movement of his transactions as a whole. For him every transaction is part of a composite *continuum*, and only properly intelligible as a link in a chain. From the balance sheet standpoint a new loan is usually only a replacement of a loan repaid, and not a device for bringing about a new deposit.

In times of major economic disturbance special factors operate. In modern war conditions especially the characteristics of an isolated system emerge and many of the checks and balances of peace time are virtually inoperative. Enormous increases of Government debt are reflected in large creations of deposits in which the banker is little more than a passive instrument. The restraint ordinarily applied by the forces determining reserves is removed by State creation of cash without regard to exchange consequences which for the time being are obviated by drastic official control. It has been through the operation of these circumstances in Britain and their repercussion on Irish external trade that the major part of the growth of Irish bank deposits in the past thirty years has taken place. Similar large-scale developments in peace time are naturally improbable in uncontrolled regimes. The enormous growth, however, of the public debt of the United States in the New Deal period was the active factor in causing a pronounced rise in the deposits of the banks in that country. The movement in that case was accompanied by a large influx of gold.

Enough has probably been said to enable us now to see the snares which lie in such familiar phrases as "Every banker creates his own deposits" and "Every loan creates a deposit." That they contain elements of truth cannot be denied, but therein lies their deceitfulness. Those who seek to gain a real knowledge of actual banking in this country

or elsewhere must not be deterred by catch-phrases from seeking the whole truth, which is more than even the sum of two half-truths.

It is evident that if they profess to give the whole truth the expressions quoted are mutually contradictory, for the first ignores, while the second tacitly admits, the role of the borrower. In fact both are faulty in ignoring many factors that require qualifications so extensive as to make the expressions almost worthless as a guide to what really happens. Statements of fact made earlier in this paper show clearly that the greater part of Irish bank deposits cannot be said in any intelligible sense to have been created by the Irish banker. If we wish to keep nearer to the truth we may perhaps say that a banking system creates its own deposits, but possibly we are then in the position of speaking merely truthfully but not usefully.

The notion that "every loan creates a deposit" savours too much of the hen and the egg to be treated seriously. It is no doubt intended to convey that an extension of loans entails an extension of deposits, but even in this form is unacceptable. Extended lending may well entail loss of reserves to another country. It does not then follow that a diminution of deposits in the first country will be compensated for by an increase in the second as reserve arrangements, and other relevant conditions may be different in the two areas. The liability to movement of reserves into and out of a country is manifestly of particular importance where, as in our case, the proportion of external to internal trade is high.

To conclude it should be stated that it is no part of the intention of this paper to minimise the important role of the banker in our monetary affairs or to suggest that he is merely a passive operator in the banking system. The contrary is so well known as to require no emphasis to-day. We have been concerned chiefly with giving some indications that the role of the banker is too often exaggerated, that other actors in the banking system have a part of great importance which they do not always realise, and that it may be a great practical error to fail to distinguish between what a banker is theoretically in a position to do and how he acts normally as a reasonable being. There are many who find a false consolation in blaming the monetary system for faults of which it is innocent who would not dream of denouncing the cutlery system when a criminal slits the throat of his neighbour with a carving knife.

DISCUSSION.

Professor George Duncan: I have great pleasure in proposing a vote of thanks to Mr. Brennan. His paper is an attempt to realise what is happening in a realistic and concrete manner at the moment, debunking a lot of the mystical nonsense which has been piled up by every kind of crank for the last forty years.

It is, perhaps, rather interesting to remark that there are two names in particular which are constantly recurring—the names of two persons of the highest eminence whose unguarded remarks have been used by the immense army of cranks and theorists—those of Reginald McKenna and Lord Keynes. I have here in my hand a reprint of an article written by Mr. McKenna in the *Bankers' Magazine* of December, 1942, which in many ways amounts to a recantation of many of the statements in regard to loans creating deposits on which most of this particular nonsense has been founded in the past, and in which he uses words which are very similar to those we heard from Mr. Brennan. There are two pillars, or two foundations,

for the monetary crank. One is a remark made by Mr. McKenna years ago that every loan creates its deposit, and the other is a remark by Lord Keynes that the volume of money is something that is independent of the volume of activity, and the volume of activity depends on the volume of money, rather than the other way around. Mr. McKenna, like Keynes, exposed himself to misconceptions in using phraseology rather like a form of shorthand, understandable to the banker, but not to the crank who read the paper and attempted to build a structure on top of it.

There are three parts in Mr. Brennan's paper which are worthy of the utmost attention. In the first, he insists on the inevitable equation of every credit transaction with a debit. You cannot create a debit without a credit—the two things go together. The second case is instanced by the fact that a banker's business is an integrated continuum in which he tries to preserve a certain balance and in which he does not consider the individual consequences of each transaction. The third is still more important—he makes the point that the primary activity comes not from the banker at all but from his customer. I feel that this is a very important point which is usually left out of account.

I would like to draw attention to a number of detailed points on the paper. The first one is in relation to Table I on the first page, which sets out a series of figures relating to banking operations in this country, and the same problem arises in relation to the tables on page 64, and the remarks made in the last few lines of page 68. The statistical point I would like to raise now is that the tables quite leave out of account the circulation of legal tender notes and the amount of the investments held by the Currency Commission. They necessarily, also, leave out of account the various savings bank schemes, including trustee savings banks. Would it not be possible for us to construct and to have published regularly a composite table of all banking activities in this country, including these activities I have just mentioned? Between 1933 and 1935, a great part of the bank circulation had been replaced by legal tender notes, but the table does not include them and might thus give a wrong impression. Composite tables including all these details should be given.

The second point is quite proper to Mr. Brennan's discussion about movements in bills, loans, advances and investments. Here there is another minor statistical point which is, perhaps, worth mentioning. Item (b) in Table II is "Bills, Loans and Advances". For 1939, this total (£54·4 millions) included £23,000,000 of Government bills. For all practical purposes, those bills were not bills at all, but investments, and it might be more correct to include them under item (c) of the same table. The main point I want to draw attention to, like Mr. Brennan, is the series of changes taking place in the balance of payments—changes which could well have developed as a result either of internal or external activity. In this case, they have actually been due to external activity; in other cases, it is possible they could happen as a result of internal activity.

There is a further point on page 64. In the middle of the second paragraph, Mr. Brennan states:

" . . . In time, however, an inflationary increase of note issue would tend in normal conditions to create a situation unfavourable to the retention of sterling."

That, of course, is perfectly true, but other things could happen as

well, and not every increase in note issue would be inflationary. There are three circumstances in which there could be increases in note issue which would not have any inflationary effect although a combination of each of them is taking place. The first is an increase in liquidity, an increase of cash holdings. It is of great importance in England. The second is a shift of incomes. If, as a result of Government economic policy, there is a certain shift of income from or to the farming class, then there is a greater demand for cash, and where you have such a shift of income there will be a greater use of cash and a greater circulation of notes. The third factor is an increase in output. That would necessarily mean an increase in monetary circulation. In fact, that has not happened in this country for the last ten years.

On page 66, Mr. Brennan says:

“If, too, we wish to discuss agricultural credit, it is not enough to be content with advocating extensive and generous credit for the farmer. To do this is mere beating of the air unless we also consider how far and in what circumstances we can advise the farmer to contract debt. . . .”

and so on. That is perfectly true, but the general argument of the crank when he comes to a commission is that you do not need to consider the credit position of the witnesses, or the ability of the farmer or his solvency—what you want to do is to provide him with credit that need not be repaid. We all know that there is an answer to that, but we must meet these people some time or another at their own point.

One further question is the position of cash in relation to the banking system. The real question is this: are the deposits of the banking system still in the United Kingdom the motive power, or is it not the other way, that the volume of deposits in the banking system is determined by the total volume of activity and the technique of providing cash giving the volume necessary to sustain the volume of deposits? The matter was different when we had the gold standard. But the cash was not made up entirely of gold; it was made up of balances at the Bank of England, and even under the simple gold standard, it was not a limited amount which determined the amount of the deposits. It was, itself capable of fluctuation. If you are dealing with a managed currency which is linked to some objective such as exchange rates, then under these circumstances your cash provision is more elastic and more dependent, in advanced banking systems on your deposits. I propose the cordial thanks of the Society be extended to Mr. Brennan for his valuable address.

Professor T. W. Dillon: I feel a little frightened and flattered at being asked to second the vote of thanks, because I have no claim whatever to expert knowledge of banking or economics. I am as frightened as if I had been put up to represent the frightful cranks denounced so eloquently by Professor Duncan. I hope it is not so, because the cranks would be ill-served, I myself being an orthodox person.

I find Mr. Brennan's paper extraordinarily lucid and full of information which is not available to outside persons, while containing a good deal of information not readily available even to inside persons. On the other hand, I do not think that we have in the paper a full discussion—I say this with great trepidation and I expect a trenchant

answer—of the difficulties which give rise to doubts in the minds of those who have not got expert knowledge of the economics of banking. It seems to me that the main difficulty has not been glossed over, but left out. The functions of commercial banks have been very recently stated by Mr. McKenna as not only those of arranging in what direction the credit shall go, but also the dividing up of credit among the various possible applicants or users. There, I think, is the real crux of the question in Ireland. Since the spirit of the paper is mainly informative, I would like to ask Dr. Brennan if he could possibly explain or deal with the difficulty of the social effect of the relatively high rate of interest to the less creditworthy applicant in this country. He did mention agriculture, but this arises not only in connection with agriculture.

Even in a paper of this kind, I think we tend to lose our appreciation of the close-knit operational framework of the banking system. In pursuing individual aspects of it, we tend to lose track of the system as a whole—I think it is fair to talk of it as a whole. On page 70 of his paper, Mr. Brennan does allow that every action of the banker takes place within a continuum and that every action is linked with corresponding action occurring in other parts of the system. The system as a whole does tend by charging different rates of interest to limit activities of some kinds and to increase others. That is another aspect of the problem raised by Professor Duncan. If at any time in Ireland the rates of loans were brought down—through a reduction of the bank rate which is one of the factors governing it—to a lower level, it would have a very considerable effect on the people who would use the credit. I do not intend to try to deal with the technical problems arising in this connection, but I should like to say one thing more: Mr. Brennan, on page 69, refers to the existence of a high volume of time deposits with a low volume of current deposits, and makes the remark:

“It is at the same time one which tends to make the way of inflation treacherously easy in this country, and consequently requires both the greatest vigilance on the part of the banker and intelligent understanding on the part of the public.”

That is the factor which makes the way of inflation so easy, Mr. Brennan says. But in what way can the vigilance of the banker in this country prevent inflation when it occurs as the result of considerably increased capital activity by the English Government? In actual fact, the figures shown by Mr. Brennan on page 63 demonstrates that our available cash has risen from £12,000,000 to £25,000,000 within a couple of years. How can mechanism be devised by which our bankers and our system can prevent the inflationary effects of that? Are we not faced with a system that any action we take fails, having regard to another country in which the transactions are of such a size and scope that they entirely dwarf and offset any particular small decisions we take over here? That question has often been put to me, and I hope I may hear it answered before the close of the discussion. I warmly second the vote of thanks to Mr. Brennan.

Colonel Edgeworth: I should like to begin by commending the Council's desire to disperse some of the fog which appears to obscure most public discussion on monetary and banking policy. There are

a number of fundamental questions which need answers, and it is important that the answers should be correct, and that they should be expressed in such a form that the ordinary educated man can understand them and appreciate their validity.

The paper correctly emphasises the fact that the banks are essentially intermediaries whose function is to establish contact between the real lenders, who are the depositors, and the real borrowers, who are the Government, and other recipients of the bank's advances. If the depositors become dissatisfied at the way in which the banks handle their business, they can withdraw their deposits and hoard or invest them in other ways. In actual fact, the depositors expect complete security, and the policy of the banks has to be adjusted accordingly.

On the theoretical side, I confess that I find the paper somewhat disappointing, as it seems to me that it leaves unanswered most of the fundamental questions which are perplexing men's minds at the present time. In the first place, there is a question whether the volume of deposits is determined by the depositors or by the banks. I think I am correct in saying that Mr. Brennan's attitude, with perhaps slight reservations, is that the volume of deposits is determined by the depositors. On the other hand, a number of well-known writers on the subject have asserted quite positively and without reservation that the volume of deposits is determined by the policy of the Central Bank. It is an undoubted fact that the whole policy of the Bank of England during the latter half of the 19th century was based on the assumption that the bank did possess the power of controlling the volume of its own deposits. In the time at my disposal, it would not be possible to give a complete and reasoned answer to my own question, and I will content myself with hinting that the answer which was correct fifty years ago may not be equally correct to-day, and that the inconsistency to which I have directed attention may be apparent and not real.

Another question is whether monetary and banking policy has not been seriously affected by the change from a gold coinage to a paper currency, and also by the change from the gold standard to the sterling standard. On the question of the currency, it is evident that most countries cannot produce gold and can acquire it only by exporting goods, whereas a paper currency can be augmented or diminished as required. Has this fact involved any change in banking policy, and, if so, what? I suggest that it has, and that the change is of fundamental importance. Under the gold standard it was considered that a country which acquired too much gold should increase its imports, and that a country with too little gold should increase its exports. In the past twenty or thirty years, this policy has been completely abandoned all over the world. Has banking policy been influenced by the change, or by other economic changes which have taken place in the same period? I suggest that it has.

Finally, there is a popular belief that money and banking in this country is seriously influenced by decisions taken by the Bank of England. Is there any truth in this belief, and if so, how much?

Rev. E. J. Coyne, S.J., said: I suspect that the Chairman is looking for a nice fat Christian to show to the lions! I would like to make it perfectly clear that I cannot speak for any school of thought with regard to this question of monetary or credit reform, but I do

know what a number of intelligent men are thinking about it. I think it is worth while to show what non-economists from sociologists to philosophers are turning over in their minds. Despite Professor Duncan's rather abrupt dismissal of people who talked nonsense—and I agree with him that there has been a considerable amount of nonsense spoken on monetary problems during the past forty years—the fact remains that there are serious, intelligent and responsible men who have thought this question out in all its fundamentals, and they are extremely anxious, not in their own interests, but in the interests of the community that some agreement or understanding should be found between their difficulties and what I might call the orthodox system described by Mr. Brennan. I would like to add my voice to those who have thanked Mr. Brennan for the soundness and sincerity of the information contained in this paper. Personally, I agree with the substance of the paper with one or two exceptions.

May I put this view to you? These men who are thinking about social reform and social welfare, rather than economic prosperity, are concerned with the fact that the savings of the nation are a matter of prime importance. It is a question of private people having a right to use it if they wish and a right to save it, but private property has a social aspect as well as an individual aspect and they also believe that the community has a right to a say in the use of private property in the form of savings. In other words, they think the community, if necessary for the welfare of the whole people should have some control of the pattern of savings, of the rate of savings, of the inducement to save and of the type of person who saves. I cannot develop that. Most of the savings are done by means of depreciation funds and insurance companies, and whether that is desirable or whether there should be some other method I am unable to discuss now. But, I can say this: that in a famous Encyclical it was clearly stated that it was the official opinion of a number of intelligent advisers of a certain highly placed person that there was too much saving on one side and too little on the other.

The second big thing these gentlemen are thinking about is this: that the investment of savings is as equally important to the welfare of the community as the savings themselves, and that although a man has a right to use his private property as his own, saving and investing it according to his own choosing, still there is a social aspect of those investments as well and that the community, through a central authority, should have some effective say or control, if necessary, for the welfare of the community, in the direction of investment, the amount of the investment and the rate charged. These gentlemen went on to think that the kingpin by which they might get some form of control over these two things, savings and investments, is the banking system. It is quite easy to say that there are a number of other ways in which savings could be controlled and investments controlled, but these people put the query to experts: would it be possible for a central authority to influence the amount and direction of savings and investments by having some form of control over the banking system, and, if so, what particular form of control would achieve that object without bringing about a collapse of the banking and economic system? These gentlemen are not cranks and are not talking nonsense—they are genuinely seeking information. Some of them may, I fear, express their views in a manner more vigorous than academic, but we ought to try to look at their suggestions.

The philosophers, if I may so call them, analysed the nature of bank deposits, and I stand without the slightest hesitation four square with them in this—it may seem a little bit pedantic or academic theorising but if we want to get fruitful results it must be on the basis of absolute clarity of thought—a modern bank deposit to-day is created and can only be created by a banker. Let me explain that clearly. A deposit to-day is a debt of the banker to his customer. That is the ethical position; I can speak with authority on that. If I bring £10,000 in legal tender currency and ask to make a lodgment, in law and in ethics that £10,000 ceases to be my property; it becomes the property of the banker. The banker, in return, makes an entry in his ledger crediting me with a deposit of £10,000 and that deposit is mine. The banker has created a debt against himself in his books. That is known to-day as a bank deposit. That has been created in consideration of an equivalent amount of legal tender. I am speaking about what I know—that is ethics. The customer has no ethical claim on the £10,000 worth of currency. He has an ethical right on the debt of the banker. That may be said to be a mystical little bit of academic theorising—is it true or is it false? The second process is this: that the bank can just as well create the debt against itself without receiving the £10,000. Anybody who likes can issue an I.O.U. Many of the banks are not too ready to put themselves into debt to anybody, but what is to prevent them issuing an I.O.U. or creating a debt against themselves. The point of these gentlemen is that these bank deposits, the moment they are created, become money and are used in the exchange of real wealth, and that the creation of money is something which might be under the control of the central government.

Mr. F. C. King said: As I have been rather puzzled by the problem which the last speaker has raised, I should like to say a few words to try to satisfy myself on the question of bankers creating credit and deposits. I take a different view from Father Coyne. I think that the banker is a kind of merchant of credit. When I pay £1,000 into the bank I buy £1,000 worth of credit, but I doubt whether the banker creates that credit. If I buy a pair of shoes, I likewise pay a certain amount of money, but I do not hold that the shopkeeper has created those shoes. It may be an entirely false argument, but it is a possible line of thought which needs to be dealt with before we can finally accept that bankers do create credit and bank deposits.

There is one other point I should like to allude to. It is the question raised by Professor Dillon about interest rates. He asked why cannot there be lower rates of interest so as to promote the diffusion of credit, presumably in order to stimulate industry. We find there are various means in this country intended to stimulate industry: tariffs, subsidies, and so forth, for all of which the community has to pay because the stimulation of industry is regarded as a national benefit. It seems to me that the proposal that the bankers should have to bear the entire cost of stimulating industry by this means, lowering of the interest rates below the market level, needs some ethical justification.

Mr. B. Menton, M.Sc.: It is stated on page 65:

“It is abundantly clear that in credit creation in this country between 1933 and 1941, the dominant rôle has been that of the Government.”

This is not only true of this country during that period; it is also true of other countries, particularly Great Britain and the United States. It raises the question whether commercial banking is not changing its character.

Traditionally, a bank borrowed the savings of the public and lent them at short term to commerce and industry. This was so particularly of Irish banking prior to the war of 1914-18. To-day, however, the deposits of the banks represent the current cash of the public, rather than its savings, and at the same time, there has been a long-term tendency for the demand for bank credit by the community to decline. Industry and commerce in Great Britain and the United States are becoming self-financing to a large extent, and even in cases where this is not possible, they are tending to find other means than the short-term bank advance. This probably explains the inelasticity of loans in the United States between 1933 and 1939, referred to in page 8, a period during which the indices of economic activity rose. At the moment, the main liability of the banks in the United States and Great Britain is the circulating medium of the country, and their main assets fixed loans to their Governments. These data hold for this country, except that deposits here represent the savings of the public rather than its current cash, and the Government loans are loans to the British Government rather than to their own Government.

The changed character of commercial banking has created serious problems. One was in the news recently—the need for bankers to increase their charges. Banks are finding it increasingly difficult to meet the cost of holding deposits from the return they receive in Government loans. The alternative to increased charges is a Government subsidy to the depositor paid by way of an increased rate of interest. The Government, therefore, has a direct interest in the banks charges to their customers. That particular problem is a headache for the bankers, but, in addition, there have been important repercussions affecting the interests of the nation at large.

Before the war of 1914-18, advances of the Irish banks represented well over 70 per cent. of deposits. They were primarily lenders of money. To-day, the Irish banking system is essentially a deposit banking system. At the end of 1941, as we see in this paper, advances to the public within Éire represented less than one-third of deposits within Éire. Although the deposits are mostly in the nature of savings deposits, the Irish banks are probably to-day the most liquid in the world. I think that herein lies the problem of Irish banking. Liquidity may be a virtue from the banks' point of view, but it is extremely doubtful whether the degree of liquidity of the assets of the Irish banks, having regard to the nature of their liabilities, is desirable from the nation's point of view. If the banks can do nothing about it because they are liable to repay depositors on demand, then it should be tackled from the depositors' end. As Dr. Brennan says, the banks are only one element in the situation.

The Majority Report of the Banking Commission stressed, and rightly so, that the only road to prosperity was increased productivity and efficiency. If this is to be secured, however, it is vital that the optimum use should be obtained from the savings of the public. This is certainly not the case at present. A large percentage of the deposits of the Irish banks are really permanent savings. Money could be safely used at medium or long-term. Where this is so, there

is a loss to the country and a loss to the depositor represented by the difference between 1 per cent. and 4 per cent. or 5 per cent. The banks are not to blame; it is the people who decide that their savings shall be kept liquid. The causes of this go very deep. Inertia may be a big factor.

Dr. Brennan has stated that it is a possible view that current accounts are better anchored at a bank than time deposits. I think it is true that in a time of crisis a system with a relatively large volume of time or savings deposits is more likely to be subject to pressure, and the banks in this country must, therefore, hold easily realisable securities. The point is, however, that real savings should not be placed on deposit with banks. They should be invested where they will obtain the greatest return consistent with security, and this is not in the London Money Market. There is also the question of their use in development at home. The agricultural industry, for example, could absorb profitably a considerable amount of capital. There appears to be need for specialist institutions to provide for the wider use of savings within the country. It would be essential for such institutions to make extensive use of propaganda.

Mr. J. C. Eason: I would like to add my congratulations to those already given to Mr. Brennan for his paper here this evening. I listened to Father Coyne's challenging references to certain problems. It occurs to me that the heading of Mr. Brennan's paper excludes one from dealing with the subject from the point of view of social welfare. Have we not forgotten altogether what purpose the banks serve? If I use the service of a bank it is for business transactions, because they provide a convenient and suitable form of mechanism for enabling the commercial community to perform its functions. Banks provide funds when business funds run low because other people have deposited money with them. Now, it is suggested, as far as I gather, that something should be done to alter the character of the commercial banks and that when they get deposits, they will be told by somebody else what to do with them. At present, they lend them to other people within limits; they invest them when they cannot make advances, but all the time they are responsible to their shareholders and their depositors. I wonder how long they would retain their present character of usefulness if the funds which go into their hands are to be used in a manner determined by some other body. I am not quite clear what is involved by the expression "pattern of savings", because savings cannot form any particular pattern—they represent money not spent but put into the hands of someone else to keep until wanted. As regards funds for investment, it does not seem to me that any helpful suggestion has been made. We have heard it said that the funds should be controlled on behalf of people who can make use of them, but there has been nothing about the price that would be paid for this. It seems dangerous to suggest that a group of bank directors are to determine, from their own experience and wishes, the most satisfactory and efficient method of dealing with depositors' money. I do not say that I am going to rule it out, but on the bare statement of the case, it rather disturbs me. I wonder if it would be a wise proposal. After all, the Government already take a large part of the savings and determine expenditure by taxation. That is an arrangement under the control of the people as a whole through the Houses of the Legislature, and the people can elect

members there who will carry out their wishes. The proposals regarding the commercial banks open a rather unpleasant prospect.

The President, **Professor George O'Brien**, said: I shall put the vote of thanks, and in doing so, I want to say that I naturally agree with everything that has been said about the excellence of Mr. Brennan's paper. There are one or two points arising from Father Coyne's speech on which I wish to comment. In the first place, he says that he does not wish his friends to be called cranks. I shall not call them cranks. I think they are socialists. I think the trouble about his friends is that they have a certain social and political programme and they want to carry it out by means of the banks. That may or may not be a good thing. They want savings directed to certain public ends. The only point there is: if you interfere with the disposition of savings by the people, if any agent of Government authority interferes with the amount of investment or the direction of investment, that is socialism and nothing else. That is to say, the decisions will not be taken by private individuals but by the State. I am not saying that is a bad thing, but I say that it is wrong to blame the monetary system for something which is not a monetary evil but a social or political evil. The advocates of these social and political programmes often seem to be united in blaming the bankers for evils for which they are in no way responsible. Assuming that it is desirable that control of investment should be taken out of the hands of private savers, it must be remembered that savings can be made in other ways than by means of banks; and if potential savers think their bank deposits are going to be tampered with, they may save in all sorts of other ways to escape control. Control, to be effective, must be extended to every alternative channel of saving. Commercial banks are only one of the methods of saving and unless the population are willing to have their savings invested by the Government they can escape the public control by saving outside the commercial banking system. If the net is placed around the banking system, then it must also be spread much farther. What is wanted is a certain social and political programme, which the monetary system is alleged to obstruct. The monetary system is there to do certain things, yet it is blamed for not doing other things it is not suitable for accomplishing. I think the whole matter is dealt with fairly well in Chapter V and Appendix 15 of the Report of the Banking Commission. The only point I want to make about what these people want is that everybody in this country is planning everybody else's future and nobody is planning his own! All sorts of countries are planning. Father Coyne's philosophic friends are planning too, and what they are planning is to get hold of the savings in the banks. Whether that is a good thing or a bad thing is a matter of opinion. What we need in a discussion like this is clarity of thought.

The second thing I want to say is that banks do create deposits. A deposit is a debt by a bank and, therefore, nobody can be put into debt except by his own volition. If anybody puts cash at the disposal of a bank, the bank acknowledges its debt—in other words, the bank creates a deposit, a debt against itself. Similarly, if a customer borrows from a bank the bank creates, by the act of lending, a debt against itself. In the former case the consideration is the addition which the customer makes to the bank's cash resources; in the latter case the consideration is repayment of a sum with interest. In either case, the deposit is created by the bank and by nobody else; that is

elementary and no one disputes it. The point in dispute is that the bank cannot create a deposit by making a loan unless somebody is willing to come and borrow. The bank cannot create a debt by its own unilateral action; the initiative must always be taken by the customer. The initiative is never taken by the bank. There must be a second party to every transaction by which banks create a deposit. That, I think, is a correct statement of the case.

Finally, I disagree with Father Coyne when he suggests that a deposit is money. It is simply a claim to money and there is a great deal of confusion on account of the failure to make this distinction. There was an unfortunate analogy made by the late Walter Leaf regarding cloak room tickets, and it is at the bottom of a good deal of the confusion. Mr. Leaf said that a cloak room attendant cannot create tickets for cloaks in excess of the number of cloaks deposited with him. A cloak room attendant could create claims to cloaks if everybody's cloak could be exchanged for everybody else's and if he was sure that not more than 10 per cent. of those left on deposit with him would be demanded at one time. In that way, a cloak room attendant could do a thriving business and make a handsome profit by lending out claims to cloaks. The bank does not create cash but claims to cash, and I think that is a fundamental distinction. A bank can create credit if it has a willing party, either a private individual or a Government, to collaborate with in depositing cash or in taking a loan. The creation of such credits gives rise to new deposits, but not to new cash, and, therefore, not to new money.

I do not wish to become too argumentative in the Chair, but Father Coyne did ask for an answer to two questions. The first one was as to savings. It is quite possible to control savings and investment, but by doing so, individualism disappears and you have a planned economy. The second point is that a banker does not create a deposit on his own initiative. He does not create money; he creates a claim to money. Money can only be created by the Central Bank, but that is another story. I now put the vote of thanks.

Mr. Brennan, in acknowledging the vote of thanks, said: I expected a much more vigorous onslaught on the paper. If it is not giving anything away, I might mention, perhaps, one point I thought of dealing with in the paper but decided it was better to avoid it because of its complexity. It arises on the reference to net sterling assets in Table II on page 63. I was waiting for somebody to challenge me on the line that some of these net sterling assets might be said to be loans. One could develop a nice argument on that but, of course, the real point involved is that in discussing questions like loans creating deposits, the leading writers have never, so far as I know, brought it down to the point at which it was necessary to discuss what happened where you had an overlapping banking system such as you have between this country and England. There are very difficult questions arising there, and if any of you care to devote your thoughts to it, you will find it rather involved. I hope the line taken is correct that these sterling assets are not part of the banking system of this country and that where an Irish bank holds sterling, so far as concerns the position in this country, it is largely immaterial whether it is Bank of England notes or balances with the Bank of England or British Government securities.

It is very important to keep in mind the high proportion in this country of note currency to active bank money as explained in the paper. There is a great likelihood, where loans are taken from an Irish bank, that owing to abnormal conditions in this country you would have a high proportion of those loans remaining out in the form of note currency rather than coming back as bank deposits. The proportions would be quite different from what would happen in England where such an immense proportion of the total money is actually bank money.

Professor Duncan referred to the important point that sometimes it was more a question of the volume of deposits determining the amount of cash than the amount of cash determining the volume of deposits. That, of course, is perfectly true, and it is very important in England in war time, and in other countries also in war time, and I think it was noted in the paper that it has been a large factor in the building up of the structure of Irish deposits both during the last war and during the present war. As pointed out in the paper, the reason is that you get practically a closed economic system in war time and the basic cash reserve can be expanded with impunity without the authorities having to worry very much about the possible exchange effect. In this country, however, as is also indicated in the paper, we are almost chronically in a position where the deposit structure does not depend, except in a slight way, upon what may be regarded as the cash reserves. Cash in our case, I do not think, amounts to very much of liquid or reasonably liquid sterling, and the position is totally different from where the reserves are defined in a more stringent fashion and where either a statutory or conventional ratio is applied more or less rigidly.

Professor Dillon made some references to relatively high interest rates for less credit-worthy borrowers. I rather avoided, as you may have noticed, getting into the question of interest at all in this paper. It was kept to rather broad-considerations and for the particular purpose of the paper, interest rates did not seem to be of leading importance, but it may be no harm to recall that this matter was very closely examined by the Banking Commission, and the conclusions of that body did not at all bear out the notion so often heard of in this country that our interest rates are relatively high. I need not go into that. Anyone who wants to pursue it knows where to find the answer, but in the last resort, the real test is the gap between, on the one hand, the interest rates charged on loans and, on the other hand, the rates allowed on deposits and the expense of running a bank, and how that gap works out as regards the general profitability of the conduct of the business of banking. There does not appear to be evidence—at least those who have examined the matter and who have indicated their views, those in authority have not been satisfied that this gap was such as to lead to profit rates so considerable that one could say that interest rates were generally excessive.

Dr. Dillon also asked the question whether banks could do anything to prevent inflation coming about here by reason, as I understood it, of the large expansion of deposits occurring in Britain in war conditions. I am not sure that it might not be a possible reply to him to consult some of the farmers who borrowed in 1920 and 1921 and many of whom, as you know, blame the banks for being too accommodating inasmuch as they were said to have forced loans on farmers at that time. The mere abstinence from giving accommoda-

tion at such a time when inflationary prices are about is obviously an illustration of what can help to prevent the position getting worse than it need be. The mere possession in this country of large amounts of sterling does not necessarily mean that we have inflation. The problem is in more people getting hold of it and wanting to spend it. This problem is not confined to war time. In America, they have had to sterilise large quantities of gold from other parts of the world. A great deal can be done to keep in check prices which if left unchecked would create inflation.

Colonel Edgeworth, I think, went a little bit farther than others with the point that it was indicated in the paper that the volume of deposits in this country was determined by depositors. I do not want to say anything further on that, but I want to controvert the notion that it was determined primarily by bankers. I think that the general drift of the paper is directed towards indicating that both that and other factors in relation to banks are the composite result of the action of bankers and customers. A large part—I think it may be said the greater part—has arisen otherwise than by the initiative of bankers. Deposits arose during the first World War and are now due to the large gains in sterling that are being secured by people engaged in external transactions, but I do not mean to imply, nor would it be correct, that the volume of our deposits was not determined to some extent by the banks.

Father Coyne has already been answered by our President. He said he wanted to bring under notice a view entertained by certain schools of thought, and I was not quite clear how far he meant us to presume his own agreement with the views he expressed. But, when one takes these suggested controls, surely the onus in the first place is on those who advocate controls to indicate that some specific object not attained at present might be secured, and that the controls indicated will give the desired results. It is very difficult to deal with vague statements that controls are necessary. We want to be told what is wrong. We want some illustration, something more tangible that it is possible to talk about. This matter has been examined with a great deal of care in the Report of the Banking Commission, but one cannot make much progress unless advocates of control, on whom the onus rests, tell us or give us some indication of the precise points where control will produce results and where the controls are to be. I am afraid Father Coyne, towards the close of his remarks, did repeat that banking deposits can only be created by a bank. Surely, it is evident that banking deposits have been created—it is a difficult word—but for very intelligible reasons they have been created chiefly by those who received certain sums of money from their sales in England and deposited them with Irish banks. One can say that to some extent the acceptance of these lodgments by the bank is the creation of a deposit, but it does not describe the reality of the transaction. The initiative and the essential feature of the transaction is that some trader or customer has come in with so much sterling and deposited it in the bank. The banker might be sitting there until doomsday and he could not create a deposit until someone came in. Surely the initiative is with the man who brings in the deposit? Then, he also speaks about the banker giving a loan by making his I.O.U. That is not what happens. I am afraid that a lot of the notions about bank deposits date back to the time when banks were at liberty to issue their own notes. When a customer came in and borrowed £100, the

banker handed him £100 in his own banknotes. In that form, the banker's liability was credit. Some people have been inclined to suppose that when note issue ceased, a deposit appeared on the other side in the same way as the note issue. Nowadays, when a person borrows from a bank, all that happens immediately for practical purposes is that the customer gets his £100 and the bank cash is depleted by £100. There is no deposit on the other side. The loan is offset by diminution of cash, and it is very much of a speculation whether the equivalent is going to appear as a deposit in that bank's balance sheet. If a deposit does appear, it cannot be linked up with that loan transaction. It only creates mistakes to get away from the transaction, and I submit we must start regarding the position from that point of view so that what happens immediately is that the banker loses the cash. He may have protected himself by not making a new loan until some previous loan is paid off and the position is kept level, but whether a loan gives rise to a deposit is problematical.