

8. The general advantages of such an institution, if based on sound principles, are, I think, very considerable. It would, obviously, perform the functions that might be discharged by either of the two alternative organizations mentioned above ; but it would, in addition, be able to exercise a gradually increasing influence over the credit situation in New Zealand, and by timely action minimize the disturbances in either direction which are liable to arise out of an unregulated or imperfectly regulated market. A Reserve Bank would further provide machinery which is not only useful but also indispensable for the gradual development over a period of years of a short-term money market in New Zealand. Finally, such a bank would provide an instrument for co-operation with the Central Banks of other countries—a co-operation which is becoming of increasing importance and which at present finds no suitable point of contact in New Zealand.

I am aware that certain objections may be urged against the establishment of a Reserve Bank in New Zealand in the present stage of the country's development. It may be argued that the money-market of the country is at present too slightly developed either to make it necessary to have a Reserve Bank, or to render the adequate functioning of such a bank possible if it were established. It may be said that in New Zealand there is no bill-market, no short-loan market, and, generally speaking, no money-market in the full sense of the term, and that in the absence of these features the services that could be rendered by a Central Bank would be greatly curtailed.

I have given mature consideration to these arguments, and, without wishing to minimize their importance, I am definitely of opinion that they do not constitute insuperable objections to the establishment of a Reserve Bank in New Zealand. I have outlined above the principal advantages which would accrue from the establishment of such a bank, and I would repeat that if the absence of such factors as a short-term market and a bill-market leaves a gap in the financial structure of the country the process of closing such a gap can begin in no other way, or certainly in no more effective way, than by the establishment of a Reserve Bank. A money-market follows the creation of adequate central machinery, and cannot effectively exist, or be expected to exist, until the machinery is available. Nor am I of opinion that the volume of New Zealand's financial transactions, internal and external, and the development of her banking system, are insufficient to warrant the establishment of a Reserve Bank : it is perhaps enough to point out that not only South Africa but many European countries of less financial importance have established and are operating successfully a modern type of central bank.

9. But the recommendation to establish a Reserve Bank is subject to two fundamental conditions.

In the first place, the bank must be entirely free from both the actual fact and the fear of political interference. If that cannot be secured, its existence will do more harm than good, for, while a Central Bank must serve the community, it cannot carry out its difficult technical functions and cannot hope to form a connecting-link with the other Central Banks of the world if it is subject to political pressure or to influences other than economic. Experience has shown that the best method of safeguarding the independence of a Central Bank is to constitute the Central Bank as a private corporation with a capital subscribed by the general public and an independent Board of Directors elected by the shareholders. Such a constitution does not mean that the bank is conducted for the private profit of a few individuals, for it is perfectly competent to limit the maximum dividends, to provide for the payment to the State of any excess profits, to limit the voting-rights of the shareholders so as to prevent the undue prominence of any single group, to place restrictions on the choice of directors, and, if desired, to provide for the confirmation of the appointment of the Governor and Deputy Governor by the Governor-General.

In the second place, in order that the bank may effectively discharge its functions in regulating the credit conditions of a country, it should hold both the banking balances of the Government and the reserve balances of the trading banks. Trading banks are bound to hold liquid reserves, and it is no hardship to them that those reserves should be concentrated in a Reserve Bank. In fact, it is usual that