

England, the Central Bank can acquit itself of its liability in respect of the redemption of its notes by tendering, at its option, either gold or foreign gold exchange (that is to say, payment in the legal-tender currency of a country effectively bound to allow the export of gold), and in consequence is authorized to hold such foreign exchange as part of its gold reserve. The degree to which such countries in fact pay in foreign exchange as against gold varies, but a system by which they pay solely in gold foreign exchange is a well-recognized and perfectly practicable method. It has for years been the practice of the Indian Government, which maintains for the purpose sterling reserves in London. It is the practice of Currency Boards in many parts of the Empire. It is also the practice of the Irish Free State, whose Note-issue Board hold reserves in London, mostly invested in short-term sterling bills, and who undertake a liability to pay their notes in London in sterling or to give notes in Dublin for sterling at fixed rates.

I recommend that New Zealand should formally adopt the sterling exchange standard, thereby bringing the regulations governing the currency system into accord with standing practice and providing a separate basis for New Zealand exchange dependent only on her own balance of payments, and incidentally transforming into an earning asset the present holding of dormant gold.

6. It would, I think, be difficult to make it mandatory on private banks to buy or sell sterling at rates not exceeding the limits of the import and export gold points. For this reason, and, indeed, also from the point of view of general currency practice, it would appear desirable to concentrate the New Zealand note-issue in the hands of one authority. A single and uniform note-issue is an essential principle of central banking, and, with few exceptions, has been adopted by all modern countries. It is not desirable that the privilege of issuing legal-tender money should be in the hands of private trading banks, and, as banks who surrender such a privilege are also relieved of the liability for their notes, they have no reason to complain of the transfer of the note-issuing privilege to a central body, especially in a case where, as in New Zealand, the level of special taxation on note-issues has reached a point at which (according to the banks' statement) the issue is no longer profitable.

7. The status, constitution, and functions of the body which should manage a unified note-issue obviously depend to a great extent on the size and complexity of the unit involved and the purposes which it is desired to achieve. I do not think that either a Notes Board or a Currency and Exchange Board would offer a permanently satisfactory solution in New Zealand.

The functions of a Notes Board would be purely automatic. Such a Board would have no other function than the internal management of the currency, involving, after the initial replacement of the existing note-issues, no more than the issue of notes against such assets as might be authorized by law. The defect of such an organization is that not only could the Board have no influence on the development of the credit situation, but it would have no effective means of regulating the exchange in accordance with that situation.

A Currency and Exchange Board charged with the statutory duty not only of managing the note-issue, but also of providing exchange, would have a slightly larger scope. Such a Board would undertake to buy and sell exchange within the gold points. If the exchange showed signs of weakening in London, the New Zealand office of the Board would offer to sell exchange on London at a fixed price. If New Zealand money showed signs of appreciating in terms of sterling, the office of the Board in London would offer to sell exchange on New Zealand at appropriate rates. This scheme has the merit of connecting the maintenance of the exchange with the management of the note-issue. It has, however, the defect that the credit conditions which might make for unstable exchanges could not directly be influenced by the Exchange Board, which could only operate to the extent of the assets it actually held.

The course which I should recommend would be the establishment (as in other Dominions) of a Reserve Bank of a size appropriate to New Zealand's conditions. Such a bank would necessarily be charged with the duty of managing the note-issue, accepting the responsibility for the ultimate stability of the exchange, holding reserve balances of the trading banks, and carrying the Government account.