Effects of Changes in Banking and Exchange Control Legislation in the United Kingdom on the Significance of the Money Aggregates as Indicators 1971-81*

I. Introduction

In the decade 1971-81 there were several changes made to banking legislation in the United Kingdom. In September 1971 the banking system was deregulated. At the end of 1973 the "corset" was introduced; it was removed in early 1975, re-introduced at the end of 1976, then removed in mid-1977 until mid-1978, when it was re-introduced. It was then finally abolished in June 1980. Until 1979, too, exchange controls, principally directed at discouraging resident outflows, were in operation. In October 1979 these controls were completely abolished.

These developments had important implications for the significance of the various money aggregates as indicators of the thrust of the monetary sector. This paper will try to review the ways in which the monetary aggregates have been "distorted" as indicators by the changes in legislation which have occurred.

We consider the distortions to the money aggregates, created by changes in legislation, under three headings: (a) the effects of Competition and Credit Control (CCC), (b) the effects of the Supplementary Special Deposits Scheme ("corset") and (c) the effects of the removal of exchange controls.

To put the matter in historical perspective there are eight relevant phases:

1. From the implementation of Competition and Credit Control (CCC) in September 1971 to the introduction of the corset in December 1973.

* An early draft was completed while the author was a consultant with the European Department at the International Monetary Fund. He is grateful to IMF colleagues for comments. The author is also grateful to R. Tucci-Barrions and A. Johannessen for research assistance.

II. Competition and Credit Control (CCC)

The principal changes introduced by CCC in September 1971 were the following: controls over bank interest rates were lifted; lending ceilings, which had been the principal method of monetary control up to then, were discontinued; the 8 per cent minimum cash ratio and the 28 per cent minimum liquid asset ratio were both replaced by a 1½ per cent cash ratio and a 12½ per cent minimum reserve asset ratio, respectively. From our standpoint the freeing of controls over bank lending and interest rates was the most important development. Table 1 tries to provide a detailed indication of how the money aggregates would have been distorted by deregulation.

It is evident from a close examination of the table that the effects are very complicated. We concentrate on the effects of deregulation, i.e., the effects of the banks' competitive bidding for funds which followed deregulation.

To begin, the banks can attract funds out of currency into interest-bearing deposits. In this case, M1 will fall but SMd and M2 will be unchanged. Clearly, M3 will now be a poor indicator, since there has not been any change in private sector liquidity.

In principle, too, the banks could attract funds from overseas: if residents switch from foreign deposits SMd will rise but M1 and M2 will be unchanged. Now SMd will be a poor indicator while M1 and M2 will be better indicators.

The inflow into interest-bearing deposits may also come from demand deposits. In this case M1 will be distorted.

The higher interest rates offered on interest-bearing deposits may also attract funds from outside the banking system (e.g., from finance houses, building societies, etc.). This forces up market interest rates; the probable end result is some fall in M1 while SMd remains unchanged.

Table 1

<table>
<thead>
<tr>
<th>Potential Source of Funds to Banks</th>
<th>Effects on Bank Reserves</th>
<th>Implications for Money Aggregates as Indicators</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Currency</td>
<td>Increase</td>
<td>M1 down, SMd and M2 unaffected. SMd and M2 better indicators than M1.</td>
</tr>
<tr>
<td>2. Residents switch from foreign currency</td>
<td>Increase</td>
<td>SMd up, M1 and M2 unaffected. M1, M2, better indicators than SMd.</td>
</tr>
<tr>
<td>3. Non-resident inflow</td>
<td>Increase</td>
<td>M1, SMd and M2 all unaffected. All three good indicators.</td>
</tr>
<tr>
<td>4. Demand deposit</td>
<td>None</td>
<td>M1 down, SMd and M2 unaffected. M1, distorted – inferior as an indicator.</td>
</tr>
<tr>
<td>5. Other financial assets</td>
<td>None</td>
<td>M1 down, SMd and M2 unaffectd. M1, distorted – inferior as an indicator.</td>
</tr>
<tr>
<td>6. Reduced free reserves</td>
<td>None</td>
<td>Increase in SMd, M2. Assumed no effect on M1, SMd and M2 indicators.</td>
</tr>
<tr>
<td>7. Advances (&quot;round tripping&quot;)</td>
<td>None</td>
<td>Increase in SMd, M2. No change in M1, M2. Better indicator.</td>
</tr>
<tr>
<td>8. Multiple expansion from excess reserves</td>
<td>None</td>
<td>Assumed increase in SMd, M2, SMd, M2 better indicators.</td>
</tr>
</tbody>
</table>

1 Assumes the monetary aggregates are not affected by following deregulation.
2 Assumes foreign exchange rates.
3 Indicates effect of shift.

In the post-CCC environment with sterling relatively weak this could not have been important.
Now, however, SM₃ will be a poor indicator because although SM₃ is unchanged the thrust of the monetary sector is now restrictive (i.e., there is now an increase in the demand for M₃, which is deflationary). In this case M₃ might be the better indicator.

If the interest rate on advances adjusts upward more slowly than the interest rate on time deposits there is a possibility that the latter will be higher than the former, encouraging "round tripping" i.e., borrowing to place funds in interest-bearing deposits. Now SM₃ and M₃ will record an increase while M₁ will be unchanged. Although round-tripping creates additional deposits, these are, by definition, held idle and hence have no significance for aggregate demand. Now SM₃ and M₃ are distorted while M₁ is the better indicator. This round-tripping did in fact become significant in the United Kingdom in the course of 1973.

Finally, there is the potential multiple expansion of deposits from excess reserves. Deregulation itself created some excess reserves: principally from shifts out of currency; but as we also noted CCC lowered reserve requirements which would have led to some deposit creation. Much of the deposit creation would have ended up in the form of interest-bearing deposits. So now SM₃ and M₃ would be much better indicators than M₁.

To summarise then, CCC would have distorted the money aggregates in many ways. In some cases M₃, in other cases SM₃, would have been distorted. It is evident from the analysis that neither M₁ nor M₃ would, other things being equal, have been very good indicators in the postCCC environment. But the analysis undertaken above does leave a strong presumption that, on balance, SM₃ would probably have been a superior indicator.

The growth of M₃ in 1972 and 1973 was much more modest than the growth of SM₃ (Table 2). From some 14 per cent growth in 1971, SM₃ grew at some 25 per cent in the subsequent two years. The growth of M₃, however, fell from 17 per cent in 1971 to some 13 per cent in 1972, then fell sharply again to 5 per cent in 1973 (Table 2). The very sharp acceleration in inflation which occurred in 1974 and 1975 is clearly much better related to the behavior of SM₃ than M₃, and this is largely consistent with our own interpretation of the money aggregates.

Our own analysis suggests that, following CCC, one would have expected (a) a fall in the currency to total deposit ratio, (b) a fall in the cash deposit ratio, (c) a fall (rise) in the sight (interest bearing) to total deposit ratio, and (d) a rise in the SM₃ money multiplier. These expectations were in fact completely fulfilled in the relevant years (Table 3). From end-1970 to end-1973 the currency to total deposit ratio fell from 22 per cent to some 16 per cent. Over the same period the cash deposit ratio fell from 7.5 per cent to 4.5 per cent, while the sight (interest-bearing) to total deposit ratio fell (rose) from 44 (52) per cent to 32 (65) per cent. Finally, the money multiplier rose from 4.1 to 5.7.

III. The Supplementary Special Deposits Scheme ("Corset")

1. Background

The corset was first introduced in December 1973. Its principal aim was to contain the growth of sterling M₃ which, as we have seen, had been growing very rapidly in the previous two years. It laid down

<table>
<thead>
<tr>
<th>Year</th>
<th>B</th>
<th>M₃</th>
<th>SM₃</th>
<th>M₄</th>
<th>SM₄</th>
</tr>
</thead>
<tbody>
<tr>
<td>1971</td>
<td>8.5</td>
<td>17.0</td>
<td>14.6</td>
<td>13.8</td>
<td>9.4</td>
</tr>
<tr>
<td>1972</td>
<td>11.1</td>
<td>13.4</td>
<td>26.4</td>
<td>27.6</td>
<td>7.1</td>
</tr>
<tr>
<td>1973</td>
<td>8.2</td>
<td>5.1</td>
<td>26.0</td>
<td>27.6</td>
<td>9.2</td>
</tr>
<tr>
<td>1974</td>
<td>17.0</td>
<td>10.8</td>
<td>10.2</td>
<td>12.6</td>
<td>16.0</td>
</tr>
<tr>
<td>1975</td>
<td>12.6</td>
<td>18.6</td>
<td>6.5</td>
<td>7.6</td>
<td>24.2</td>
</tr>
<tr>
<td>1976</td>
<td>11.5</td>
<td>11.3</td>
<td>9.5</td>
<td>11.2</td>
<td>16.5</td>
</tr>
<tr>
<td>1977</td>
<td>13.9</td>
<td>21.3</td>
<td>10.0</td>
<td>9.8</td>
<td>15.8</td>
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<td>1978</td>
<td>14.9</td>
<td>16.4</td>
<td>14.9</td>
<td>14.9</td>
<td>4.3</td>
</tr>
<tr>
<td>1979</td>
<td>8.4</td>
<td>9.1</td>
<td>12.7</td>
<td>12.3</td>
<td>15.4</td>
</tr>
<tr>
<td>1980</td>
<td>2.6</td>
<td>3.9</td>
<td>18.6</td>
<td>18.7</td>
<td>18.0</td>
</tr>
<tr>
<td>1981</td>
<td>5.1</td>
<td>9.8</td>
<td>13.6</td>
<td>18.0</td>
<td>11.9</td>
</tr>
</tbody>
</table>

B = base money.  
1. From end year to end year.  
2. Per cent change in consumer prices.  

This is a broad agreement with the analysis in HOWARD (1981).

For details and analysis of the corset see Bank of England Quarterly Bulletin (1982).
TABLE 3

<table>
<thead>
<tr>
<th>Year</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8</th>
<th>9</th>
<th>10</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970</td>
<td>2.2</td>
<td>4.1</td>
<td>4.2</td>
<td>7.5</td>
<td>22.4</td>
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<td>3.5</td>
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<td>4.3</td>
<td>4.4</td>
<td>6.4</td>
<td>21.7</td>
<td>45.8</td>
<td>51.1</td>
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<td>4.9</td>
<td>5.1</td>
<td>5.1</td>
<td>19.1</td>
<td>40.2</td>
<td>56.9</td>
<td>2.9</td>
<td>3.5</td>
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<tr>
<td>1973</td>
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<td>5.7</td>
<td>6.0</td>
<td>4.4</td>
<td>15.8</td>
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<td>5.4</td>
<td>5.8</td>
<td>4.8</td>
<td>18.6</td>
<td>32.0</td>
<td>65.9</td>
<td>2.2</td>
<td>7.9</td>
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<tr>
<td>1975</td>
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<td>18.6</td>
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<td>5.0</td>
<td>5.3</td>
<td>4.4</td>
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<td>37.0</td>
<td>60.3</td>
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<td>11.5</td>
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<tr>
<td>1977</td>
<td>2.5</td>
<td>4.8</td>
<td>5.3</td>
<td>4.4</td>
<td>20.3</td>
<td>42.3</td>
<td>54.1</td>
<td>3.4</td>
<td>11.4</td>
</tr>
<tr>
<td>1978</td>
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<td>4.8</td>
<td>5.3</td>
<td>4.3</td>
<td>20.6</td>
<td>43.2</td>
<td>53.8</td>
<td>3.0</td>
<td>11.4</td>
</tr>
<tr>
<td>1979</td>
<td>2.6</td>
<td>5.0</td>
<td>5.5</td>
<td>4.0</td>
<td>19.8</td>
<td>41.5</td>
<td>55.9</td>
<td>2.6</td>
<td>10.9</td>
</tr>
<tr>
<td>1980</td>
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<td>5.8</td>
<td>6.4</td>
<td>2.7</td>
<td>16.3</td>
<td>35.2</td>
<td>62.1</td>
<td>2.7</td>
<td>10.8</td>
</tr>
<tr>
<td>1981</td>
<td>2.7</td>
<td>6.3</td>
<td>7.1</td>
<td>2.3</td>
<td>16.2</td>
<td>34.2</td>
<td>63.4</td>
<td>2.4</td>
<td>13.7</td>
</tr>
</tbody>
</table>

Note: Last six columns are in per cent.

B = Bank money
BC = Banks' deposits with Bank of England and banknotes and coins
PNC = Notes and coins in circulation with public
PSTD = Prime minister's special deposits
PSTD = Prime minister's special deposits
PSID = Prime minister's special deposits
BD = Banks' deposits with Bank of England
D = BC + PNC
SM = PNC + PSTD + PSID + BD + M1
M = PNC + PSTD + PSID + BD + RF

B = BC + PNC

M = PNC + PSTD + PSID + BD + M1

SM = PNC + PSTD + PSID + BD + M1

M = PNC + PSTD + PSID + BD + RF

2. How the corset distorted the money aggregates

As would be expected, whenever a control system comes into operation, the imposition of the corset generated a variety of reactions by the banking system and their customers aimed at offsetting or relieving the effects of the new legislation.

First, the corset induced some "onshore" disintermediation. One important form this took became known as the "bill leak." Banks would accept bills issued by customers and then sell these to nonbank holders. The bills, which did not appear as liabilities on the books of the banks, were similar to the certificates of deposit whose growth was being restricted by the legislation.

There are two questions to ask here. First, how significant was this leak? Second, given its scale, what did it imply about the meaning of the money aggregates as indicators?

During the first corset period (1974 to February 1975) bills held outside the banking system rose from £350 million to some £500 million. During the second corset period (end-1976 to August 1977) these bills increased from £320 million (to which they had dropped in the intervening period) to some £430 million. During the third corset (mid-1978 to June 1980) period the bills rose from a new low base of some £150 million to some £2,700 million. These again fell dramatically soon after the abolition of the corset. It is evident, then, from the fluctuation in these bills that they bore a consistent relationship with the imposition and abolition of the corset.

What significance should be attached to these figures and what do they imply for the meaning of the money aggregates as indicators?

It is difficult to see the bill leak as a "complete" offset to the corset as if, in other words, those bills were the exact equivalent to the growth

* These figures are taken from the Bank of England Quarterly Bulletin (1982) p. 62. For difficulties in measuring this leak see COGILLAN (1979). It is also worth noting that the banks had an incentive to run down these bills and increase their eligible liabilities in anticipation of the corset.
of SM₃. The reason is that with banks restrained the growth of borrowing and lending outside the banking system requires some increase in interest rates and hence implies some restriction.

This is not to say, however, that they ought to be totally discounted. They represented in effect a form of "financial innovation" induced by the controls and so probably served to increase the interest elasticity of the demand for money. So while it would be illegitimate to treat the bill leak as the equivalent of sterling M₁, it nevertheless did constitute some leak.

One way of approaching this is to add the bill leak to SM, to see how it changes its rate of growth. This would provide an absolute upper limit to the offset, recognizing that in reality it would be less than this. In the first period SM rose by some 10 per cent; with the bill leak the figure is roughly 10.5 per cent. In the second period the growth in SM₂ was some 1.5 per cent; with the bill leak this becomes 1.8 per cent. In the third period the growth of SM₃ was 32 per cent; with the bill leak the growth becomes some 37 per cent. Thus, the bill leak was "significant" only in the last period. During the operation of the corset, then, the bill leak would have understated both M₁ and M₃ as indicators.

Second, the corset, after the abolition of exchange controls in November 1979, also induced some "offshore" disintermediation. U.K. residents were now able to place sterling deposits in banks overseas. These then lent them on to U.K. residents, who had been denied loans by the operation of the corset. What happens here is that the ownership of a sterling deposit shifts from one U.K. resident to another, so, although SM₃ in unaffected, additional lending is generated.

It would seem that in the first half of 1980, after the abolition of exchange controls but before the removal of the corset, U.K. residents' Eurosterling deposits more than doubled to £2.7 million. These fell sharply after the removal of the corset, suggesting some relationship with the corset.

If we treat these as having effects similar to those of the bill leak, then in the last period of the corset these would have, at most, added a further 2.25 percentage points to the growth of SM₃. So again, the money aggregates would have been distorted downward.

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11 Money lent to the discount houses was a reserve asset if it was on call and secured.
12 The precise mechanics here are not very clear. The Bank of England Quarterly Bulletin (1982) on page 79 says that "The banks would increase their nonreserve assets lending to discount houses and the funds could then be used by the banks to purchase commercial bills or other assets from the banks. In this way a fall in interest-bearing eligible liabilities could be arranged without falls in reserve assets in nonbank deposits with the banking sector or in lending to the nonbanks by the banking sector. In effect, lending to nonbanks could be shifted from the banks to the discount houses. In this case, as distinct from the other case in the text, liabilities and assets of the houses increase. The banks are in effect selling nonreserve assets to the discount houses and at the same time extending their lending to them."
3. The effects of the removal of the corset in June 1980

Because from mid-1979 the corset was producing substantial distortions to banking behavior and the money aggregates, its removal produced equally dramatic reversals. The basic analysis underlying the removal of the corset is somewhat similar to the analysis underlying the introduction of Competition and Credit Control (see again Table 1). In the (banking) month of July alone sterling M₃ grew by 5½ per cent while interest-bearing liabilities (IBEL) rose by some 14 per cent; at the same time the bill leak fell by £1,000 million. The growth of the key money aggregates in the second half of 1980 is shown in Table 4. The growth of both base money and M₁ slowed down (sharply in the last case); the growth of SM₂ and M₃, however, accelerated significantly while there was little change in the growth of private sector liquidity.

What appears to have happened is the following. There was a sharp fall in private sector holdings of money market instruments (principally in the form of bank bills). SM₂ grew most rapidly because of the very sharp increase in IBELs; the ratio of sight (interest-bearing) to total deposits fell (rose) while at the same time the SM₂/base money multiplier rose and the cash/deposit ratio fell sharply. As one would have expected, these developments almost exactly parallel the developments in 1972-73 after the banking system was first deregulated (Table 3).

What does all this imply for the money aggregates, as indicators? We concluded earlier that, while the corset was on, because of the disintermediation process, SM₃ tended to understate the thrust of the monetary sector. The removal of the corset reversed this. As a result of the reintermediation process, SM₃ now tended to overstate the thrust of the monetary sector. This view was in fact widely held and indeed allowed for at the time the corset was removed. At the same time M₁ was also significantly distorted. The shift into interest-bearing deposits sharply reduced the demand for M₁, so row M₁ understated the thrust of the monetary sector.¹²

¹² It is widely held that M₁ growth in 1980/81 is a better indicator of the thrust of the monetary sector than SM₃ growth. The reasoning seems to be based on the observed fact that inflation fell sharply in 1982, hence that there must have been some slowing down in the growth of some money aggregate. We have argued that M₁, and indeed base money, are also distorted downwards. The fall in inflation may have more to do with non-monetary factors (e.g., the fall in commodity prices in 1982, the restrictive fiscal policy and the world recession, the fall in interest rates and the effects of the disintermediation of bank on wage demands) than monetary factors.

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<table>
<thead>
<tr>
<th>Table 4</th>
<th>United Kingdom: Monetary Aggregates (end of period, seasonally adjusted)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year</td>
<td>M₁</td>
</tr>
<tr>
<td>1980</td>
<td>6.2%</td>
</tr>
<tr>
<td>1981</td>
<td>6.4%</td>
</tr>
<tr>
<td>1982</td>
<td>6.6%</td>
</tr>
</tbody>
</table>

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Notes: A & B. The corset was imposed on 7 May 1980 and lifted on 31 May 1981. The corset applied only to sterling deposits with banks. C. Money aggregates do not include bank bills or interbank claims (other than those of ICB). D. The rise in sterling is highlighted for the period 1980/81. E. The table shows the ratio of money aggregates to GDP. F. The table shows the ratio of money aggregates to GDP.
IV. The Removal of Exchange Controls

The removal of exchange controls induced U.K. residents to increase their holdings of Eurosterling deposits and as well of foreign currency deposits. On the former, it is worth noting that since the abolition of exchange controls, the ratio of U.K. residents' Eurosterling deposits to domestic deposits rose from 1 per cent to 2 per cent. Eurostanding deposits are not included in either SM3 or in M3 so a significant increase in these holdings presumably distorts all money aggregates including M1, SM3 and M3.

On the latter, Table 5 shows that, on a transactions basis, there was a significant increase in 1980/81 in foreign currency holdings. However, if we also take account of valuation effects resident holdings of foreign currency did not increase significantly until 1981.\textsuperscript{13} M4 includes foreign currency holdings valued in sterling, so it is sensitive to valuation changes. On this basis the removal of exchange controls may have distorted M1 and SM3 but possibly not until 1981.

<table>
<thead>
<tr>
<th>Year</th>
<th>Transactions basis ending</th>
<th>As a percentage of M4 in previous year</th>
<th>Resident holdings of foreign currency as a percentage of M4 in previous year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1977</td>
<td>+ 778</td>
<td>1.7</td>
<td>0.8</td>
</tr>
<tr>
<td>1978</td>
<td>+ 910</td>
<td>1.8</td>
<td>0.9</td>
</tr>
<tr>
<td>1979</td>
<td>+ 802</td>
<td>1.4</td>
<td>0.9</td>
</tr>
<tr>
<td>1980</td>
<td>+ 1,515</td>
<td>2.4</td>
<td>0.9</td>
</tr>
<tr>
<td>1981</td>
<td>+ 2,659</td>
<td>3.4</td>
<td>1.2\textsuperscript{1}</td>
</tr>
</tbody>
</table>

\textsuperscript{1} Mid-quarter quarter-on-quarter to data in fourth quarter.

V. Some Tentative Conclusions

The principal conclusions appear to be the following:

1. Competition and Credit Control, introduced in September 1971, had significant effects on the monetary aggregates as signals of the thrust of the monetary sector. These effects, however, were very complex, sometimes distorting one aggregate, sometimes distorting another. Our own conclusion was that it almost certainly distorted M4 more than SM3, so the latter was a better, albeit still misleading, indicator of the monetary thrust.

2. The corset was introduced at the end of 1973, removed early in 1975, reintroduced at the end of 1976, then removed in mid-1977, until mid-1978 when it was reintroduced. We have argued that over period (from end-1973 to mid-1978), while certain distortions may have occurred, these would have been very small. This is not surprising considering that in the first two periods when the corset was in use there were only minimal penalties actually paid and most of the time banks were below their allowable limits.

However, during the third period (particularly from mid-1979) banks were running up against their limits and indeed paying substantial penalties for infringement, so, not surprisingly, the corset did then begin to bite. We have argued that the operation of the corset acted to understake SM3 as an indicator. This effect was reinforced over the period when the corset was in force and exchange controls removed. By contrast, after the corset was removed SM3 tended to overstate SM3 or an indicator.

3. The important point that needs to be made is that whenever a particular monetary aggregate is made scarce by a system of controls, the financial system will tend to adjust, in part at least, by creating substitutes (Goodhart's Law). This in turn will weaken the significance of the money aggregate both as an indicator and as a target. What happened in the United Kingdom as a consequence of the corset would most likely have also happened if instead of controlling SM3 by the corset some other form of control (e.g., base money control) had been used.

4. A most striking feature of the U.K. is the divergences which appear in the growth in the money aggregate (Table 2). This is particularly
noticeable for \( M_4 \) and \( SM_2 \). With the possible exception of 1979, the
two money aggregates flash conflicting signals in every other year. In
many of the years the two money aggregates actually moved in opposite
directions. Some of these conflicts, as we have seen, could be explained
in terms of changes in banking legislation but by no means all. Indeed,
the discrepancies persisted in years (1974-77) when legislation was only
having a minimal effect; moreover, they continued (in 1981) even after
all controls were abandoned.

5. It is worth noting that the money multiplier appears to be more
stable for \( M_4 \) than for \( SM_2 \) (Table 3). It is also particularly noteworthy
in our context that, in 1972-73 and again in 1980 when the money
multipliers for \( SM_2 \) rose very sharply, the multiplier for \( M_4 \) remained
relatively stable. The reason for the latter is that, in those years, the fall
in the bank cash deposit ratio and as well in the currency deposit ratio
was offset by the sharp fall in the sight deposit to total deposit ratio (see
Equations 5 and 6 in Table 3).

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The International Debt Problem
in the Interwar Period *

1. The history of international debt is the history of international
finance. It is many centuries old and it is closely linked to international
political history. The political element was seldom absent from interna-
tional finance for the very simple reason that in many cases, and for a long
time in the majority of cases, although creditors were mostly private
financial houses, debtors were political authorities. The purely economic
international loan incurred by the individual or firm in order to be used
for productive purposes and dispensed by another firm in order to
maximize profits, can be safely assigned to a minority shelf, with most
episodes belonging either to the pre-1914 or post-1960 periods of world
history.

The inter-war period is perhaps the high noon of politicized interna-
tional finance. The variety of cases of political and economic interaction
in the field of international debt is so great that one can be sure he can find
in that period a precedent for whatever case of politicized international
economics he is studying.

The years that follow the First World War could be read, for what
international financial and monetary affairs are concerned, in the light of
continuity with the pre-1914 period. The substitution of British hegemony
with American hegemony in the world economy was taking shape in
the decade before the war. The International gold standard was a fast
degenerating international monetary regime before the war destroyed it.
The European major powers had already managed to make their distur-
bning presence felt in the previously British-dominated world financial
market.

The international telegraph had already been introduced and tran-
scendental telegraph had been a reality for several decades. Financial

* This paper was written while the author was a member of The Institute for Advanced Study.
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