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The policy origins of the Reserve Bank of New Zealand[1]

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The Reserve Bank of New Zealand formally began operations on 1 August 1934, with responsibility for currency issue, debt management and the exchange rate. Although the establishment of the Bank can be seen partly as a response to the depression of the early 1930s, it also reflected forces that played out over much of the period following the First World War. Britain's push to see its Dominions establish their own central banks and the long-standing case for an independent New Zealand currency were both important factors shaping the debate around the case for a central bank. This article discusses these historical influences, the personalities that played a key role in the policy debate, and the events that culminated in the opening of the Bank.

1 Introduction

The Reserve Bank of New Zealand formally began operations on 1 August 1934. For the first time in New Zealand a body existed with authority over currency issue, debt management, the exchange rate, and other powers that could be drawn on as required.[2] This article looks into the policy origins of the Reserve Bank, through to the mid-1930s when a newly elected Labour Government introduced a Reserve Bank Amendment Act and the major debates of the period over the role and function of a central bank were broadly brought to a close.

In the 1930s, the pressures pointing to a Reserve Bank were not always seen with clarity, and some statements of the day reflected only aspects of the wider story.[3] Time provides a perspective unavailable to participants, allowing the origins of the Bank to be more clearly seen in the context of the day. In the widest sense, the Bank was the product of decades-long discussion and an Empire-wide move towards central banking, shaped by the early twentieth century rise of bureaucracies, world war, and the industrial, technical and social change of the period. Britain was eager to see its self-governing Dominions go down this track.[4]

There was little question by the end of the 1920s that New Zealand would establish a central bank at some stage. Actually taking the step, however, reflected other pressures. In this respect, the depression of the early 1930s was an important factor, because it enabled the proposal for a central bank to effectively bridge the political spectrum. Parties of both left and right wanted one, although differing significantly on the control and role of the proposed organisation.

This was reflected in a tension between the vision of a central bank as an autonomous, largely passive bulwark of a New Zealand 'economic constitution', and one of a government agency playing an active role in the management of economic affairs in support of the government's overall policy. Policy argument therefore continued after the founding of the Bank, and the election victory of the Labour party in November 1935 meant that something closer to the latter vision eventually dominated the way the Reserve Bank was structured and run in subsequent decades.

2 Initial policy steps to 1930

The longer-term pressure driving the emergence of a Reserve Bank in New Zealand was currency issue and management. A government-run Colonial Bank of Issue briefly operated

1 I am grateful to Michael Reddell for his input into this article; Phil Briggs and Graham Howard for their work and advice on graphs; and Jo Rusk and the Reserve Bank Knowledge Centre, who provided invaluable research assistance.

2 *New Zealand Statutes*, Geo. V, 24. See also eg, Neil Quigley (1989), 'Monetary policy and the New Zealand financial system: an historical perspective', in Reserve Bank of New Zealand (eds), *Monetary Policy and the New Zealand Financial System*, 3rd Ed, Reserve Bank of New Zealand, Wellington, p. 210.

3 See, for example, J. G. Coates, (1933) 'The Reserve Bank of New Zealand Proposal', Wellington, p. 17; *New Zealand Parliamentary Debates* (NZPD), Vol. 236 (1933), p. 803.

4 John Singleton et al (2006), *Innovation and Independence*, AUP, Auckland, p. 10.

Top, Colonial Bank of Issue £5 note, 1850s, typical of colonial-era note design: centre, Bank of New Zealand £1 note, 1881, a characteristic late nineteenth century look: above, Bank of New Zealand £5 note, 1929, a style typical of early twentieth century issues. This particular series of notes were used as a conceptual basis for the first interim issue of Reserve Bank notes in 1934; features transferred across notably including the portrait of King Tawhaio. (Reserve Bank of New Zealand)

in New Zealand during the early 1850s,[5] but did not last and the onus for note issue fell back on individual banks. By the early twentieth century, the sole issuers of bank notes were the six main trading banks. Each issued currency under separate legislation, a parliamentary charter that required that the notes were convertible to gold; and that the banks held enough gold to support their issues.[6] The value of notes in circulation was thus tied to the bullion and securities held in New Zealand.[7]

There was no government agency managing the volume of notes issued, or any government effort to influence the volume of banks lending. Banks stood, in principle, on their ability to assure depositors of the convertibility of their notes into gold. There was thus no 'monetary policy'. Nor was there a 'New Zealand pound' as such, although in practice the banks did honour each other's notes.

When New Zealand entered the First World War in August 1914, the requirement to convert notes into gold was suspended, and never reinstated.[8] Superficially this switch away from gold convertibility, which followed the British lead in the war emergency, appeared to be a significant change. However, it had little practical impact for New Zealand. As Gary Hawke has observed, what had mattered for many years was the ability of the banks to meet customer demand for sterling balances – the funds in Britain that paid for imports.[9] This had disproportionate importance in early twentieth century New Zealand partly because London was the centre of the world financial system at the time; partly because Britain was by far the largest single export destination, and the dominant source of imports. In 1928, for example, Britain took £40.51 million of New Zealand's total exports, by value, of £56.18 million. The United States ran a distant second, Australia third. Imports followed a similar pattern.[10]

Increased bank lending on the New Zealand domestic market tended, all other things being equal, to increase customer demand for sterling. Consequently, the availability of sterling balances in the banks' accounts in London – arising from export receipts or capital inflows – became a major influence in the willingness and ability of the banks to increase lending.[11] This in turn influenced the level of spending and economic activity in the domestic economy.

In theory, once the gold convertibility link was suspended in 1914, the rate at which the New Zealand banks' notes

5 M. F. Lloyd-Prichard (1970), *An Economic History of New Zealand to 1939*, Collins, Auckland and London, pp. 63–65.
6 Quigley, p. 211.
7 B. C. Ashwin (1930), 'Banking and currency in New Zealand', *Economic Record*, Vols 5 & 6, 1929–1930.

8 An Order in Council, under Section 44 of the Finance Act 1916, permitted the six trading banks to count their securities in Britain and Australia against their note issues. See G. R. Hawke (1971), 'New Zealand and the return to gold in 1925.' *Australian Economic History Review* Vol. 11, p. 49.
9 Gary Hawke (1973), *Between Governments and Banks*, Reserve Bank, Wellington, p.16.
10 Lloyd-Prichard, pp. 297, 299.
11 Noted by Singleton, p. 9.

were exchanged for sterling could have fluctuated freely, in order to balance the supply of – and demand for – sterling balances, the so-called 'London funds'. In practice, the trading banks attempted to keep the rate around parity, nominally keeping a New Zealand five pound note equal in value to a Bank of England five pound note, and adjusted their lending policy accordingly – in effect, 'rationed' access to sterling funds as a mechanism for maintaining parity. This was, as Bernard Ashwin and other observers noted, effectively a 'de facto ... sterling exchange standard',[12] and it reflected the standard orthodoxy of a time when a fixed exchange rate was regarded as the natural and appropriate way to order financial affairs. Britain returned to the gold standard in 1925, at long-standing pre-war parities, partly for these reasons.

A complicating factor for New Zealand was the fact that four of the six trading banks were Australian owned. These banks each held a single pool of sterling balances, reflecting the activities and needs of both Australian and New Zealand customers. This meant that, in principle at least, the state of Australia's foreign trade affected the availability of credit and foreign exchange in New Zealand. Ashwin has argued that the New Zealand exchange rate was 'governed to a preponderating extent by Australian conditions'.[13] This linkage – which had both advantages and disadvantages – became a focus of the New Zealand debate in the late 1920s, when the weak Australian trade position was putting downward pressure on the exchange rates of both countries, pushing them away from the norm of parity with sterling, even though New Zealand's own trade accounts were in surplus.

Governments of the late 1920s had no tool with which to address this or any other monetary issues; the only actual instruments of economic management then in government hands revolved around adjustments to government revenue and expenditure, 'fiscal policy'. Although the economy was heavily dependent on foreign trade, concentrated in a few commodities in a single market, there was no mechanism to adjust or manage the exchange rate, no mechanism to influence interest rates, and no mechanism to influence the availability of credit.

This was the gap that a central bank came to fill. Central banks, some established by statute, often with private shareholders, were more common internationally by the early twentieth century and had begun to assume a central role in the financial system. The most prominent was the Bank of England. The US Federal Reserve system was established in 1913, and by the 1920s all the major European nations had central banks.

These institutions emerged at a time when there was intense debate over how to manage monetary affairs in the developed world; in the United States, for instance, one Presidential election was fought largely around the role of gold. More radical thinkers increasingly saw an active role for the state in the management of banking and money, going beyond simply maintaining an exchange rate peg such as the gold standard.

New Zealand was not immune to the debate. Setting aside the Colonial Bank of Issue, which was driven fairly directly by currency issue needs, the notion of a more active role for the state in the economy emerged periodically during the later colonial period and after, particularly whenever there was a period of economic or financial stress.[14] The Legislative Council, New Zealand's Upper House, passed a motion in 1884 recommending that the government establish a state bank of note issue. Pressure for change increased the following decade when the government obtained a share in the Bank of New Zealand as a result of the banking crisis of 1893; there were calls for the government to use this organisation to influence interest rates and even 'undertake some central banking functions.[15] There were regular calls to use this bank as a government policy instrument, even to influence interest rates, but in the event no steps were taken.[16]

12 Ashwin, p. 194.
13 *Ibid*, p. 198.

14 Reserve Bank of New Zealand (1955), *Monetary and Fiscal Policy in New Zealand: submissions to the Royal Commission on Monetary, Banking and Credit Systems 1955*, Reserve Bank of New Zealand, Wellington, p. 6. Hereafter *Monetary and Fiscal Policy*.
15 Quigley, p. 209.
16 See, eg, *Monetary and Fiscal Policy*, p. 6.

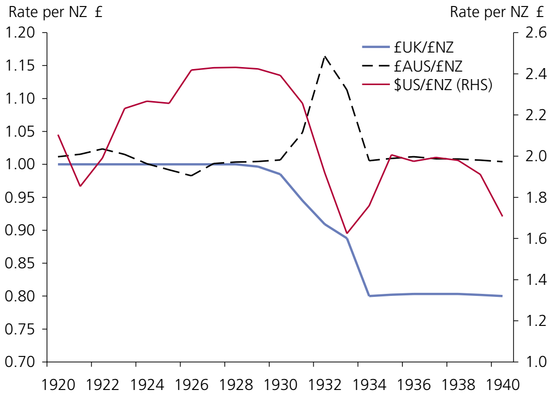
There was also no central bank of issue, and in 1911 the Liberal government – reformist and seeing a larger role for the state in everyday life – introduced a New Zealand Notes Bill, intended to give the government sole right of note issue. This lapsed when the Liberals lost office in November. Reform came to power, under William Massey – a Premier who was, as N. M. Chappell put it, 'as wedded to conservatism as he was to the soil'.[17]

Arguably the relative conservatism of Massey's administration hindered New Zealand's adoption of a central bank. However, external pressures to establish one continued to grow, particularly after the First World War. Britain was eager to see its Dominions establish their own central banks in wake of the war, and the idea was discussed in Imperial conference as early as 1920, and again in 1923.[18] Much of the drive behind this came from a desire to restore the stability in national and international finance of the pre-war period. A central bank, on this conception, was part of re-establishing the norm of the gold standard; and central banks were also seen as institutions which should operate at arm's length from government.

These relatively conservative views stood in some contrast with those of New Zealand's Labour Party of the period, which also wanted a state bank and saw potential in turning the Bank of New Zealand into one. However, the focus was quite different in that Labour envisaged an explicitly state owned and managed central bank, seeing any organisation largely as a device for keeping the banking sector under control and interest rates low.[19]

Massey did not entertain such notions, and this position was not so anomalous by Imperial standards. Australia had set up a Commonwealth Bank in 1911, but this had very limited powers by comparison with a full central bank. Canada and Ireland did not have central banks either at this time. However, although Massey died in office in 1925 and was succeeded by the more centrist former Railways Minister Gordon Coates, a central bank remained off the government policy agenda and very much a platform of the Labour left,

Figure 1
New Zealand exchange rates 1920–40



Source: *Looking at the Numbers*, Phil Briggs: derived from Engel, Charles and Chang-Jin Kim (1999) "The long run US/UK real exchange rate."

which at that time had a relatively radical image. Temporary wartime legislation remained in force; New Zealand did not follow Britain back to the gold standard in 1925, and as late as 1928 another Proclamation extended the wartime legislation.[20]

This ongoing sucession of stop-gap measures, coupled with the difficulties flowing from the exchange-rate and sterling reserve relationship with Australia, finally prompted action. The 1929 budget, issued by the United administration, ostensibly under the ageing and ailing ex-Liberal Sir Joseph Ward, in practice guided by his deputy, George Forbes – called for a review of the temporary legislation covering banking, foreign exchange and currency matters, and its replacement with a permanent statute.[21] The proclamation covering legal tender was due to expire in January 1932.[22]

By this time the notion of a central bank had gained ground with The Treasury. As Malcolm McKinnon has argued, Treasury officials saw an independent central bank as an important economic tool by this time.[23] This was particularly emphasised by the developing discount rate on the pound in 1930. The exchange rate was under pressure via the sterling reserve mechanism; as Hawke has shown, the 'failure of the

17 N. M. Chappell (1961) *New Zealand Banker's Hundred; a history of the Bank of New Zealand 1861–1961*, Bank of New Zealand, Wellington, p. 269

18 Hawke (1973), *Between Governments and Banks*, p.15.

19 *Ibid*, pp. 14–15.

20 Ashwin, p. 194.

21 See, eg, Archives New Zealand T52/625, Acting Prime Minister to Chairman of Directors, Bank of New Zealand, 2 September 1930; also *Evening Post*, 3 September 1930.

22 AJHR 1931 B-3 'Banking and Currency in New Zealand, Report on', Sir Otto Niemeyer, p.1, hereafter 'Niemeyer Report'.

23 Malcolm McKinnon (2003), *Treasury*, Auckland University Press, Auckland, p. 124-125.

banks to distinguish between New Zealand and Australia' meant that the New Zealand pound was discounted against the sterling.[24] This flew in the face of a positive trade balance at that time, which prompted suggestions that the New Zealand pound should instead be set at a premium – a situation that Arnold Hore, then with the New Zealand High Commission in London, thought could be remedied with a central bank.[25]

The Treasury vision was consistent with orthodox Bank of England thinking, which envisaged an independent central bank, founded on a return to fixed exchange parities as a way of assuring 'sound money' and of differentiating New Zealand's financial position more clearly from Australia's. It was broadly supported by the urban business community, and first articulated in 1930 by Bernard Ashwin, a young Treasury economist. In an influential paper he concluded – among other things – that New Zealand's note issue should be fully covered by government securities; and that a 'Note Issue Board' should be formed which might 'in due course form the nucleus of a Central Bank'.[26]

3 Depression influences on policy

The worldwide depression that began to bite across Australasia during 1930 had significant and decisive effects for New Zealand. Export values fell sharply (figure 2), and estimates suggest that New Zealand's GDP fell by around 17 per cent between 1929 and 1931 (figure 3).[27] Commodity prices fell about 40 per cent, consumer prices by around 20 per cent (figure 4), unemployment rose sharply, and there was a sense of popular crisis.[28]

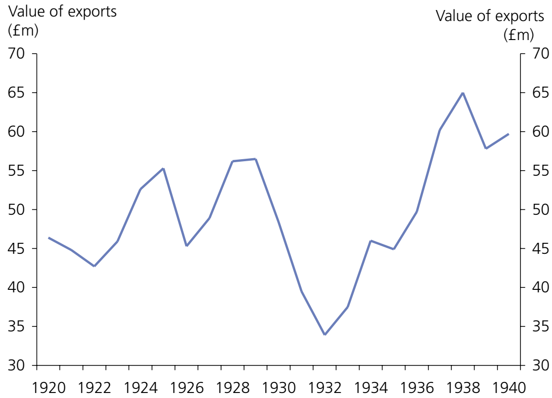
The Australian situation was more serious, not so much because commodity prices fell more sharply, but because concerns about Australian indebtedness meant that access to external credit was cut off, putting downward pressure on the exchange rate.

The Australian problem was of key importance for New Zealand because of the mingling of the sterling reserves.

[24] Hawke, p. 22.
[25] McKinnon, p. 125.
[26] Ashwin, p. 204.
[27] *Ibid*, p. 697.
[28] Lloyd-Prichard, p. 379.

Figure 2

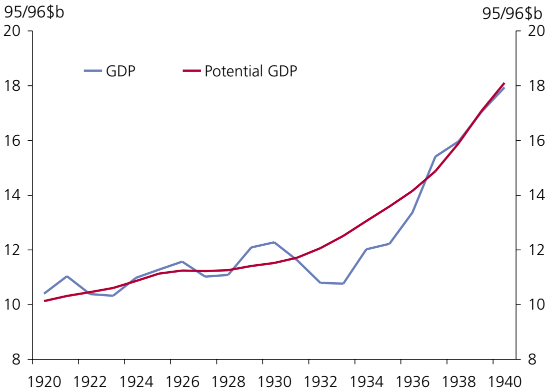
New Zealand exports by value 1920–40



Source: M. F. Lloyd-Prichard, *An Economic History of New Zealand to 1939*.

Figure 3

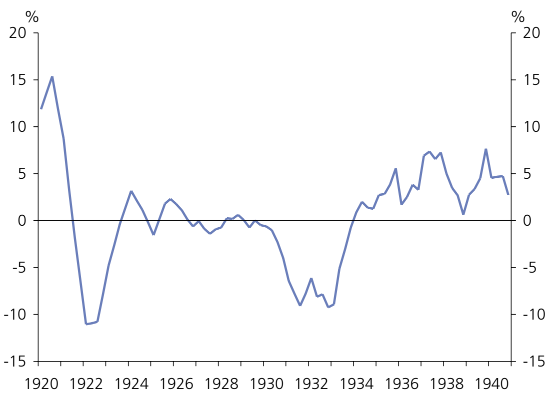
New Zealand's estimated Gross Domestic Product, 1920–40 *(real vs potential)*



Source: *Looking at the Numbers*, Phil Briggs: sourced from Keith Rankin (1991), "Gross national product estimates for NZ 1859–1939" and Brian Easton "A GDP deflator series for New Zealand 1913/14–1976/77"

Figure 4

New Zealand CPI 1920–40



Source: Statistics New Zealand.

When these were run down by the Australian banks in the face of the crisis, New Zealand suffered. As Prime Minister and Minister of Finance George Forbes remarked, the 'close banking association' with Australia and consequent link with Australian economic fortunes was significant.[29] London financiers also conflated New Zealand with Australia, though the economic situations faced by the two Dominions were quite distinct in practice.[30]

The New Zealand government took some time to respond seriously to the depression. In the inter-war years, trade and economic activity were volatile, and in orthodox circles it was generally thought that the best way to manage these fluctuations was to allow market disciplines to work, while keeping government finances in good order. This was expressed in an early focus on budget-balancing. However, the depth of the depression with its pervasive and concrete impact across the whole of New Zealand, including a material loss of public confidence in the trading banks, finally prompted a more active approach to economic management, both in New Zealand and abroad.

Economic advisers did not have a well developed framework for analysing the options, and in any case, economic analysis confronted powerful conflicting sectional interests. For example, farmers – many of whom had very large debts – now faced sharply lower export prices, and were generally sympathetic to anything that would ease their debt-service burden and raise their incomes, such as an exchange rate depreciation. Urban businesses, by contrast, while also facing a downturn, had little interest in a depreciation and regarded 'sound money' as underpinning business confidence and their willingness to invest. Urban employees – at least those in employment – had little interest in a depreciation that would raise their cost of living.

After intense debate, a variety of relatively unorthodox measures were eventually adopted. These included legislative debt relief, involuntary cuts in interest rates, emergency work schemes, and – after a significant debate – the first active state involvement in depreciating the exchange rate.

Sir Otto Ernst Niemeyer, CBE, KCB (1883-1971), seen here in the late 1940s. (Bank of England)

This was the immediate context from which the Reserve Bank finally emerged. Yet the path was by no means certain or obvious even then. Although the broad policy context on both sides of the political spectrum remained in favour of establishing a central bank by this time, there was no particular impetus towards actually doing so, and the trigger for action in 1931 was, to some extent, fortuitous. It happened that two senior British officials were due to visit Australia, broadly to advise on the Australian financial crisis.[31] According to Hawke, the idea to extend their visit to New Zealand originated with Secretary of the Treasury A D Park, who saw a newspaper report and forwarded it to Forbes with the recommendation that the British officials look into New Zealand.[32] Certainly the impetus came from The Treasury,[33] and the idea also fell on fertile ground in England. However, the decision to seek British advice was not surprising; as Frank Wood put it, New Zealand was Britain's 'most dutiful daughter',[34] and major policy decisions

29 Hawke (1973), p. 28

30 Singleton, p. 9.

31 For analysis see, e.g. Alex Millmow (2004), 'Niemeyer, Scullin and the Australian economists', *Australian Economic History Review*, Vol. 44, No. 2.

32 Hawke, pp. 26-27.

33 McKinnon, p. 126.

34 Cited in W. B. Sutch (1966), *The Quest for Security in New Zealand*, Oxford University Press, London, p. 166.

in a variety of fields were invariably undertaken only after obtaining the advice of British officials.

In July, the Government formally invited the officials to travel on to New Zealand. The advisory group comprised Sir Otto Ernst Niemeyer, CBE, KCB, of the Bank of England; and Professor Theodore E. G. Gregory, of the University of London.[35] Niemeyer had been with the British Treasury from 1906 to 1927, and with the Bank of England since 1927, was a Director of the Bank of International Settlements, and Deputy Chairman of Vickers-Armstrong Ltd among other positions.[36] By contrast with Australia, where he was seen in some circles as Britain's 'receiver', Niemeyer had a purely technical brief for New Zealand. He was asked to investigate and report on 'questions of banking, currency and exchange'. Forbes enclosed a copy of the Ashwin paper for Niemeyer's background, and the visit took place in August and September 1930.[37]

Public response to the news was varied. Lobby groups such as the Auckland and Hamilton Chambers of Commerce wanted the Government to expand the brief. These requests were politely declined.[38] There was extensive interest from the financial community, including requests by the trading banks to meet Niemeyer and Gregory.[39] At other levels, however, there was some public difficulty distinguishing Niemeyer's New Zealand brief from the one he had in Australia. One newspaper speculated that Niemeyer's arrival might give a 'wrong impression overseas' about New Zealand's financial standing, particularly in light of the depression-induced decline of the primary commodity markets. The *Dominion* opined 'A visit from one whom Australia has grimly dubbed "the bailiff" is not an occasion for rejoycing', adding that it would be 'absurd to suppose ... that Sir Otto possesses any economic cure-all'.[40] The *Evening Post* was more up-beat. 'The Government are to be congratulated on their disregard of this fear.'[41]

Surviving correspondence shows that Niemeyer was diligent and thorough; he met officials, corresponded with Park on matters such as public debt, and plied Park with reports regarding central banking elsewhere.[42] The review that followed, formally the 'Report on Banking and Currency in New Zealand', more commonly the 'Niemeyer Report', was published in New Zealand in 1931.

Niemeyer considered a central bank pivotal to any lasting structure, and recommended a 'Reserve Bank of a size appropriate to New Zealand's conditions', charged with note issue, stability of the exchange rate, and holding the reserve balances of the trading banks. Such a bank should be 'entirely free from both the actual fact and the fear of political interference', on the basis that without it, a central bank would 'do more harm than good'.[43] He backed his report with a long commentary to Park, posted from Rio de Janeiro,[44] enclosing the report 'which you can publish', along with suggested draft legislation. He also had 'some private comments on confidential points'.[45] These apparently included doubts that a Reserve Bank could be hastily established – legislation would take 'some months', and other 'immediate steps' were needed to meet the situation.[46]

Another telegram followed on 17 February,[47] and Niemeyer had more to say in the covering letter that went with the report two days later, recommending – among other things – that the government should sell its shares in the Bank of New Zealand once a Reserve Bank was in operation.[48]

Such advice was conservative, and reflected the standard Treasury and Bank of England orthodoxy of the day. A

35 *Dominion*, 4 September 1930.
36 T52/625, extract from *Who's Who* 1933.
37 Hawke (1973) p. 26.
38 T52/625, Associated Chambers of Commerce to E. A. Ransom, 19 September 1930; Acting Prime Minister to the Secretary, Associated Chambers of Commerce, 24 September 1930; Hamilton Chamber of Commerce to the Prime Minister, 6 September 1930.
39 *Op cit*, Chairman of the Banks to Acting Prime Minister, 2 September 1930.
40 *Dominion*, editorial, 3 September 1930.
41 *Evening Post*, 3 September 1930.
42 T52/625, Niemeyer to Park, 18 September 1930 and attachment.
43 Niemeyer Report, p. 4.
44 *Op cit*, High Commissioner for New Zealand to Secretary for the Treasury, cablegram, 4 February 1931.
45 *Op cit*, Niemeyer to Park, 23 January 1931, Niemeyer's emphasis.
46 *Op cit*, High Commissioner for New Zealand to Secretary for the Treasury, cablegram, 4 February 1931.
47 *Op cit*, High Commissioner for New Zealand to Secretary for the Treasury, cablegram, 17 February 1931.
48 *Op cit*, Niemeyer to Park, 19 February 1931.

central bank would manage the note issue and restore a solid foundation for money in New Zealand, independent of any political interference. This was not a vision of any sort of active monetary management. Niemeyer's advice was also predicated on the development of a central bank within a reasonable time-frame. However, in the event it took another three years for legislation to be passed; while a central bank was on the agenda in wake of Niemeyer's report, it was not a priority. But the groundwork had been laid, and there was wider consideration of the concept over the next few years.[49]

4 Formulating a Reserve Bank Act

Debate over a central bank for New Zealand in the early 1930s – politically independent or otherwise – encompassed a wide range of lobby groups, politicians, government officials and economists. Even the news that Niemeyer was writing the report spurred some to action, among them Hislop, who prepared a detailed proposal for a central bank in January 1931.[50] He may have viewed a central bank within the context of measures to get New Zealand clear of the depression; certainly his subsequent correspondence with Forbes was couched in terms of strategies to do so.[51] The idea that a central bank might rescue New Zealand from the economic crisis also surfaced later in parliamentary debate.[52] Other private input came from such individuals as F. C. Morris, who laid out his conception of a central bank in *The Accountant* in February 1931.[53] The expatriate New Zealand economist D. B. Copland added a voice to the debate, advocating exchange-rate adjustment as a means of relieving the plight of primary producers.[54] Reform Party leader and Deputy Prime Minister Gordon Coates also seems to have toyed with this concept at the time.[55]

Niemeyer's report was published in May 1931, but further progress depended on government. As Singleton has argued, Government at this time – meaning, effectively, Forbes, who was both Prime Minister and Minister of Finance – viewed a Reserve Bank as a 'technical measure', distinct from the policies needed to cope with the depression.[56] This was consistent with the relatively passive vision for the role of a central bank that had shaped Niemeyer's recommendations. Forbes clearly regarded other policies as higher priority – particularly given that the broad Reserve Bank proposal had emerged from long-standing trends, not the depression emergency. So although Forbes presented Niemeyer's report to the Committee of Supply at the end of July, he was lukewarm towards the idea of a central bank, presenting the paper with the rider that 'as some far-reaching changes are involved, and the matter is a very important one', any decisions 'should not be rushed'.[57]

Later in 1931 Forbes called for a grand all-party coalition to face the depression emergency. Labour rejected the offer; Reform prevaricated and eventually agreed, and the coalition formed in September, leaving Labour as the only significant opposition party. There was still no real opportunity to consider a Reserve Bank, however, as elections were due in December and political attention turned to the campaign. The coalition was returned to power, though Forbes handed over the Finance ministry to William Downie Stewart.

Park seized the moment to put the Reserve Bank proposal forward, but Forbes remained reluctant to reopen debate.[58] Later in 1932, however, Forbes, Deputy Prime Minister J. Gordon Coates and Stewart went to the Imperial Conference in Ottawa. When the role of central banks was discussed, delegates observed that New Zealand was 'almost unique in the British Empire in being without a responsible organisation of this nature'. This was something of an exaggeration – Canada, India and Australia did not have central banks as such either – but Coates, for one, was 'satisfied' after discussions with 'most competent authorities' in Ottawa that 'the creation of a Central Bank in New Zealand will

49 Singleton, p. 10; Hawke, pp. 30–31.
50 T52/625, Mayor of Devonport to Forbes, 19 January 1931.
51 *Op cit*, Mayor of Devonport to Forbes, 4 February 1931.
52 NZPD Vol. 246, p. 841.
53 T52/625, F.C. Morris, 'The Essential Functions of a central bank', 28 February 1931.
54 Greasley and Oxley, p. 705.
55 Michael Bassett (1995), *Coates of Kaipara*, AUP, Auckland, p. 188.
56 Singleton, p. 10.
57 AJHR 1931, B-6, 'Financial Statement', p. 19.
58 Observed by McKinnon, p. 127.

J. G. Coates, (1878–1943), Member of Parliament for Kaipara and a key figure behind the 1933 effort to establish a Reserve Bank in New Zealand. (S. P. Andrew Collection, Alexander Turnbull Library F-19049-1/1)

be a step in the right direction'.[59] The delegation went on to London; and here, Bank of England Governor Montagu Norman also urged that New Zealand should establish its own central bank, this time on the logic that it would enable New Zealand to gain full economic independence from Australia.[60]

Forbes seems, at last, to have been swayed. Stewart drafted a Reserve Bank Bill, in which shares would be held by private shareholders as well as the government, and which would operate independently from the government. Work also began on the design of a series of bank notes. However, the legislation was shortly killed when Forbes decided to bring the parliamentary session to an early close.[61] There was intense debate during this period on the exchange rate, and whether a devaluation was inevitable or appropriate. The British pound had gone off gold in 1931, and now floated; but as New Zealand's trade was mainly with the United Kingdom, this did little directly for New Zealand exporters.

59 AJHR 1932, A-6B, 'Imperial Economic Conference, Ottawa, 1932', p. 8.
60 Hawke, p. 30.
61 *Ibid*.

There was substantial tension between the old economic orthodoxies, and the agitation for measures to relieve pressure on the politically powerful farming sector. In January 1933 the Government finally instructed the banks to reduce the exchange rate to £125 New Zealand to £100 sterling, and agreed to indemnify the banks against losses on future exchange rate movements. Stewart resigned in protest,[62] and Coates became Minister of Finance in his stead.[63]

Coates' approach was distinct. In many respects he bridged the traditional left-right political divides, and his policies reflected this orientation. Although broadly conservative, he had a record for intervention – particularly in terms of public works and services – and had been repeatedly criticised for being too 'socialist'.[64] Yet from the socialist perspective he was too conservative, and he was eventually demonised by both parties. This masked his other qualities, as some of his contemporaries knew at the time, and as some historians have observed since.[65] William Sutch, writing as a champion of the left, considered Coates the 'only man of statesmanlike qualities' in the Coalition Government, crediting him with setting up the platform from which Labour was able to launch its own policies – including the Reserve Bank.[66]

Coates' enthusiasm for a central bank flowed in part from the policy debates of previous years, in part from the situation created by the depression. However, although the notion of a central bank had been bandied about in policy circles for some time, it still needed selling to the general public and to some extent to lobby groups. Coates introduced the idea with a press campaign during 1933, arguing that the bank would promote stability and produce 'cheaper credit' through its control of the bill market.[67] Nor was such an institution superfluous in a small country. 'One might just as well say that a throttle and brakes are necessary in a large motor bus, but are superfluous in a small car'.[68] He also explored some of the fallacies that had been put about in regard to the effects of a Reserve Bank, including the idea

62 Greasley and Oxley, p. 697.
63 Sutch, *Recent Economic Developments*, pp. 32–33.
64 Easton, pp. 30–31.
65 e.g., Bassett.
66 Sutch, pp. 167-168.
67 J. G. Coates (1933a), "Reserve Bank of New Zealand Proposal', Wellington, p. 4.
68 *Ibid*, p. 12.

that it would simply hand control of New Zealand's currency to the Bank of England. There had been public talk of a 'vast conspiracy alleged to be operating through central banks for the economic enslavement of the world in general'. Coates did not even attempt to dignify this 'fantastic' notion with argument.[69] These efforts, however, did not sway the trading banks, which remained consistently opposed to the notion of a central bank.

The detailed control and functions that Coates saw for a Reserve Bank has to be seen in context of his political views. Where Niemeyer sought political independence, Coates considered that overall control rested with government, defining independence instead as freedom from 'the fact, as well as the suspicion, of being influenced by other than the economic welfare of the Dominion as a whole'.[70] However, this did not mean direct day-by-day interference at an operational level, either from government or business groups; and he appears to have been seeking a balance. To reduce the risk of undue private-enterprise influence he put the Secretary of the Treasury and three government officials into the Board and reduced the vote of the public shareholders. He envisaged government taking a direct role in selecting Board members, along with power of veto over selection of the Governor and Deputy Governor. He also envisaged government oversight of the 'monetary system'.[71] This was in many respects a 'middle ground' between the market freedom envisaged by Niemeyer, and the government control advocated by Labour.

Other divergence from Niemeyer was presentational, arguably a function of Coates's need to sell a central bank to public, politicians and sector groups alike. For both Niemeyer and Coates a main theme remained 'stability', but Niemeyer thought the Reserve Bank should have control over money and credit in order to stabilise the value of its notes.[72] The 1932 draft legislation took the word 'stability' to mean the Reserve Bank had control of money and credit.[73] However, the 1933 legislation drafted under Coates' guidance referred instead, in Clause 12, to control 'over monetary circulation

The first note series issued by the Reserve Bank in 1934 was intended as a temporary measure until more permanent notes could be designed. (Reserve Bank of New Zealand)

and credit' in New Zealand, so that 'the economic welfare of the Dominion may be promoted and maintained'.[74] When challenged in the House over whether the Bank could prevent 'trading cycles – periodic inflation and deflation', Coates insisted that it could 'exercise a steadying influence'.[75]

One matter that was never debated by politicians of either persuasion was the role of the Reserve Bank in note issue; this was taken as given, and the first series of Reserve Bank notes were in design by 1933, despite the rather bumpy legislative path associated with the organisation that was expected to issue them. They were designed in some haste and widely viewed as interim until a 'proper' series of designs could be developed at more leisure once the Reserve Bank was operational.[76] However, the principal arguments regarding currency were not over whether the Bank should issue it, still less the designs; but over how the issue would be backed. Coates had his own views, and temporarily rejected tying the New Zealand pound to the British pound at parity – which would have involved reversing the 1933 devaluation.[77] For all that, the thrust of his legislation was generally conservative; as Hawke has observed, the functions adopted for the

69 *Ibid*, pp. 16–17
70 *Ibid*, pp. 3, 5.
71 *Ibid*, pp. 5–6.
72 Quigley, p. 210.
73 Hawke, p. 32.

74 24 Geo. V, Reserve Bank of New Zealand Act 1933, Clause 12.
75 NZPD, Vol. 236, p. 895.
76 Reserve Bank of New Zealand (2006), *Explaining New Zealand's Currency*, Reserve Bank, Wellington, p. 5.
77 J. G. Coates (1933a), "Reserve Bank of New Zealand Proposal', Wellington, p. 14.

Reserve Bank of New Zealand were the usual functions of a central bank at the time.[78]

The Reserve Bank Bill 1933 was presented to Parliament in late October amid substantial and brisk discussion. The second reading was interrupted, though Forbes demanded urgency; and that itself provoked a debate. Michael Joseph Savage, leader of the Labour opposition, wanted the bill 'thoroughly discussed', and the House agreed. The debate that followed, on Friday 27 October, and Tuesday 31 October – lasting through until 1.26 a.m. on 1 November – occupies nearly 100 pages in print.[79] Discussion was politicised between right and left, predictably reflecting the positions already brought to the policy debates leading up to the bill. Labour was accused of wanting to 'control the Bank'.[80] There were also suggestions that the Government was handing over sovereign rights. Finally the House agreed to read it a second time, and did so probably around midnight on 31 October.[81]

Leslie Lefeaux, Governor of the Reserve Bank 1934-40. Portrait by Archibald F. Nicoll. (Reserve Bank of New Zealand)

The Bill was passed by the House and given royal assent by the Governor-General on 27 November.[82] The precise relationship between government and central bank was left ambiguous – a point Labour immediately attacked.[83]

Choice of Governor was another contentious issue. This was something of a *fait accompli* by the time Coates introduced the 1933 legislation; the process had begun in 1932, when Norman quizzed Park on the best procedure. Park initially thought New Zealand would have to advertise, but Norman, on his own initiative, offered an official from the Bank of England's own staff. Park then met Leslie Lefeaux, the Chief Cashier – a position of more substantial import than the bland meaning of the title might suggest. This offer was not something to be turned down lightly, but the decision was set aside while the New Zealand legislation lay in abeyance.

Lefeaux appears to have been simply given the job in wake of the 1933 legislation. The news came amid public speculation that New Zealand's central bank would merely be subservient to the Bank of England – with all that this implied – and Coates had to address allegations that Lefeaux had been appointed on Bank of England advice. It was a difficult question to answer; Lefeaux had actually been put forward at the Bank of England's initiative, something Coates could not deny. But the appointment, Coates insisted, was made 'on the basis of his personal qualifications'.[84]

Ultimately this was finessing; to the uninitiated it did look as if New Zealand had merely bent to British advice. However, in context of the period Lefeaux's appointment was hardly unusual. As we have seen, New Zealand looked to Britain for advice and guidance; and senior officials in new departments of the day often did come from the 'mother country'. From the policy perspective the more crucial point was, as Hawke has argued, that Lefeaux's ideals broadly coincided with Coates' concept of the Bank.[85]

The Reserve Bank commenced operations on 1 August 1934. Curiously, although the key dates were well signalled in advance, there were no premises. Lefeaux apparently began work in the Postmaster-General's office while the latter was on holiday. He envisaged 20 staff. In the event, 60 were

78 Hawke (1973, p. 33.
79 NZPD, Vol. 236, pp 797–896.
80 *Ibid*, p. 829.
81 *Ibid*, pp. 895–896.
82 Hawke (1973), p. 31.
83 *Ibid*, p. 61.

84 *Ibid*, pp. 52–53; NZPD, Vol. 238, p. 394.
85 Hawke (1973), pp. 63–64.

On its first day of operation, the Bank issued this cheque, equating to around $2.15 billion in mid-2006 dollars. (Reserve Bank of New Zealand)

required, and temporary accommodation was shortly found in the Dominion Farmers building.[86]

The Bank brought with it a number of changes to the economic environment. Among other things, trading bank notes were replaced with Reserve Bank notes; the Government bank account was shifted from the Bank of New Zealand to the Reserve Bank; the Reserve Bank also took over the gold reserves from the trading banks, acquired the government's own foreign exchange reserves; and took responsibility for managing a fixed exchange rate at £125 New Zealand to £100 sterling. The trading banks were required to hold reserve balances at the Reserve Bank, and the Reserve Bank set a discount rate at which it would lend to banks.

These were significant changes. However, Coates did not want the public to get their hopes up: 'we must ... not expect an improved monetary system to be a panacea for all our economic ills'.[87] This again reflected the longer-term policy origins of the Bank. It is not the function of this article to assess the degree to which the Reserve Bank then contributed to the recovery from the depression. At the time, A. H. Tocker attributed the decline of interest rates during 1934 to the Reserve Bank.[88] Subsequent views differ.[89] What matters from the policy perspective is that by 1934 a new institution had been put in place to enable New Zealand to handle future shocks and disruptions more effectively.

[86] Singleton, p. 13.
[87] *Ibid*.
[88] A. H. Tocker (1934), 'The Establishment of Central Banking in New Zealand', *Economic Record*, December, p. 228.
[89] Compare eg, Singleton p. 97, Greasley and Oxley, p. 698.

"Our Financial Stork" – how cartoonist J. C. Hill (d. 1957) saw the arrival of the Reserve Bank. (Auckland Star)

5 Towards policy stability 1934–36

Establishment and early Reserve Bank operations during 1934 did not end debate over the decision to set up a central bank, either at policy–making or at more general popular level. Public and sectoral responses were significant. In some quarters there was concern about the apparent final removal of the gold standard. In other quarters, including the farming sector, there was concern that the establishment of the Reserve Bank would mean a return to sterling parity. A range of aspirations and fears were clearly still in play, and Coates felt impelled to issue a new pamphlet in December 1933, 'The Reserve Bank of New Zealand and the gold question'. Here he noted that:

> *The establishment of the Reserve Bank does not mean that New Zealand will be on the gold standard, or on the gold-exchange standard. Nor does it mean that it will be bound to sterling at any fixed and unalterable ratio...*[90]

This did not quell the policy arguments, which resumed even before the Bank was open for business. In February 1934, the Government appointed a multi-party committee

[90] J. G. Coates (1933b), 'The Reserve Bank of New Zealand and the gold question', Wellington, December, p.1

The Reserve Bank Board of Directors, 1934–35. Leslie Lefeaux sits centre frame. (Reserve Bank of New Zealand)

under Palmerston North MP J. A. Nash to look into monetary systems, standards and relationships. Members were drawn from both sides of the House and included W. Downie Stewart, with 'expert Secretariat' support from Bernard Ashwin and William Sutch. The Associated Banks, The Treasury and leading economists A. H. Tocker, Horace Belshaw and D. O. Williams were invited to give evidence.[91]

The committee thus reflected some of the most significant expertise in the field of economics that New Zealand could muster at the time. Their undeclared but overt motive was silencing the voices of the Douglas Credit movement; the committee paid special attention to the idea, even quizzing Douglas, who happened to be in the country at the time. They found no basis in his theories.[92] Instead, after receiving 98 submissions and advice from The Treasury, the committee concluded that Douglas Credit was dangerously inflationary, and supported stabilising the New Zealand pound at the 125:100 ratio.[93] This drew attention in Britain; and leading economist John Maynard Keynes concurred with the conclusion that there was nothing to be gained from inflationary proposals.[94]

However, members were far from unanimous; the three Labour members and one Independent then issued a memorandum stating their dissent, and Downie Stewart refused to sign.[95] The dissenting view was that a 'complete reconstruction of the monetary system of the Dominion' was 'essential'. The Reserve Bank, in its 1933 incarnation, was thought inadequate because it was likely to continue the sterling balance system.[96]

This was broadly indicative of the fact that the Reserve Bank's role and function underwent ongoing consideration even after the organisation was founded, of the degree to which opinion remained divided, and of where the dividing lines sat. Labour was one of the more crucial voices. They were influenced by Douglas Credit, and members continued to argue fundamental matters of Reserve Bank function and control even after the Reserve Bank began operations

91 AJHR 1934 B-3 'Report of the Monetary Committee', p.3.

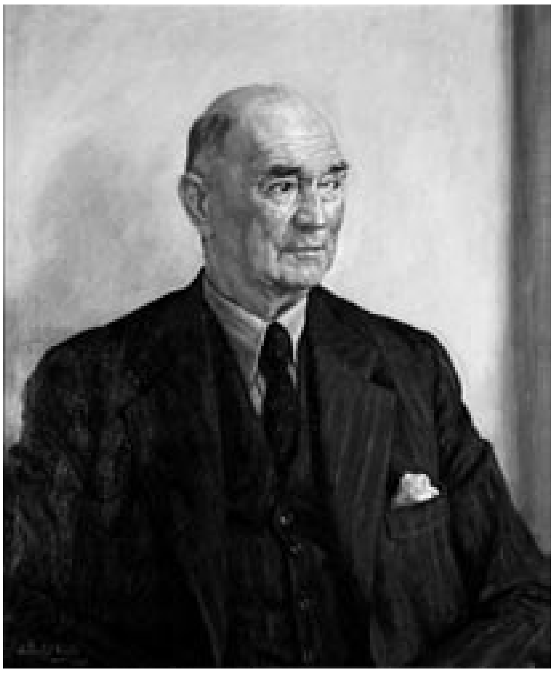
92 *Ibid*, p. 60.

93 See, eg, *ibid*, pp. 71, 75

94 J. M. Keynes (1935), 'Report of Monetary Committee, 1934, New Zealand', *The Economic Journal*, 45 (177), p. 194.

95 Chappell, p. 330.

96 AJHR 1934 B-3 'Report of the Monetary Committee', pp. 86–87.



W. F. L. Ward, Deputy Governor of the Reserve Bank 1934–40. Ward was appointed Acting Governor on Lefeaux's departure, but not appointed Governor immediately because of his age. He held the acting role until 1944, when he was finally appointed Governor, a position he held until his death in 1948. Portrait by Archibald F. Nicoll. (Reserve Bank of New Zealand)

on the Coates model.[97] There was nothing new about these differences; the issue had been well aired in the 1933 parliamentary debate, and was couched around the suggestion that the Reserve Bank Bill failed to 'establish the sovereignty of the people and of the Parliament of New Zealand over the Dominion's credit resources', failed to provide mechanism for 'credit and currency' to be available for social services, and failed to 'provide the means of increasing the purchasing power of the wage-earners, farmers, unemployed workers, and the useful people of the community generally'.[98]

To this extent the policy arguments associated with the Reserve Bank's establishment in the early 1930s remained unresolved, essentially because the visions still conflicted. This was academic when the United-Reform coalition was in power, but Labour won more than 70 per cent of the seats in the 1935 election, and the government of Michael Joseph Savage had every intention of realising its own concept of a central bank. The importance it placed on this issue was underlined by the fact that the Reserve Bank Amendment Act 1936 headed Labour's legislative programme for the year. Although called an 'amendment', this legislation actually introduced a number of fundamental shifts in the Reserve Bank's basis of establishment, function and operation. It nationalised the organisation completely, provided more scope for the Bank to extend credit to government and government agencies, and added a power that allowed the Reserve Bank to vary the reserve requirements on banks – something that became the principal tool for active monetary management in the post-war period. The amendment also brought the operation of the Bank under more overt political control.[99] As Sutch put it:

> *The Reserve Bank now has the power to underwrite Government loans, to extend long-term loans to the Government and to advance to the Government moneys on overdraft for the purchase and marketing of any New Zealand product. The Bank is directed to control all foreign exchange funds resulting from New Zealand's exports and also the transfer of overseas funds to and from New Zealand. Power is also given to prevent, if necessary, the automatic convertibility of Reserve Bank notes into sterling. The Government would therefore, if the occasion arose, be able to stop a flight of capital or ration imports.*[100]

In some respects this incorporated the ideas of the 1934 monetary committee, but more particularly it brought the Bank into line with Labour's ideas of economic management, which Walter Nash had enumerated in the 1920s.[101] To this extent the Amendment Act was not post-fact tinkering, or adaptation to changing circumstance, but a direct extension of the original policy debate; and as Sutch has also observed, it was consistent with the Labour Party's principles of the day.[102] Coates' approach had lasted less

97 Hawke (1973), p. 61.

98 NZPD Vol. 236, p. 797.

99 "Reserve Bank of New Zealand (1955), *Monetary and Fiscal Policy in New Zealand: submissions to the Royal Commission on Monetary, Banking and Credit Systems 1955*, Reserve Bank of New Zealand, Wellington, p.8

100 Sutch, *Recent Economic Developments*, pp. 34-35.

101 NZPD, 'Reserve Bank of New Zealand Amendment Bill, 1936, Parliamentary Debate; 2nd and 3rd readings, p. 143.

102 Sutch (1966), *The Quest for Security in New Zealand, 1840-1966*, pp. 206–207.

Permanent premises eluded the Reserve Bank for nearly 40 years, although efforts were made to obtain such from the outset. Architects Mitchell & Mitchell were commissioned to design a head office in 1935. The concept pictured here was developed in 1943-44.
(Reserve Bank of New Zealand)

than two years. It was a significant change. Sutch argued that no real difference was expected at daily operational level. 'In practice it is expected that the Reserve Bank will operate very much as the Commonwealth Bank of Australia (also a State institution) by being the ultimate repository for the overseas funds of the trading banks'.[103] In practise, Labour's amendment had a number of direct longer-term effects. One structural outcome was that it helped transition New Zealand into an inflationary regimen by drawing the Reserve Bank into the world of state housing finance and a guaranteed pastoral price scheme. The practical result was an increase in money supply, and a depletion of the overseas sterling reserve by some 60 per cent by December 1938.[104]

These amendments brought the Government into conflict with the Governor; Lefeaux expressed his opposition to the 1936 change and continued to operate as if the Reserve Bank did have a degree of policy independence. As Hawke has observed, Lefeaux's attitude prompted the Government to amend the legislation slightly in 1939, putting the Bank more explicitly under control of the Minister of Finance.[105] In practice this amendment had the appearance of an effort to rein in the Governor; and the dissonance of views was arguably also a factor in the Government decision not to reappoint Lefeaux when his seven-year term expired in 1940. He was instead offered an acting position, and chose not to take it.

In the widest historical context, however, there was nothing particularly radical about what Labour was doing. Although New Zealand's incarnation was somewhat ahead of the general curve, the early-to-mid twentieth century was the age of activist government and of the economic policies of John Maynard Keynes. This was ultimately expressed in both left and right flavours. Although Labour's 1936 amendment diverged from the initial policy concept of the Reserve Bank, and although radical thinking about money – including Douglas Credit – remained influential in the Labour party, the key movers-and-shakers of the mid-1930s – Nash,

103 Sutch (1936), *Recent Economic Developments*, p. 35.
104 Greasley and Oxley, p. 710.
105 Hawke (1973), p. 62, 65.

Peter Fraser and Robert Semple – represented the more conservative arm. By the 1930s, the centre of gravity in policy debates, even on the left, lay in the detail of control versus free market, not in the replacement of capitalism. Greasley and Oxley have also argued, by counter-factual exercise, that the policies Labour adopted for the Reserve Bank in 1936 may have helped bolster a startling acceleration of recovery in GDP, more so than if these policies had not been adopted. This was, they suggest, a 'striking testimony' to the 'force of the new [economic] regime' as well as the 'decisive' importance of the Reserve Bank within it.[106]

From a broad policy perspective, then, the conceptual development of the Reserve Bank spanned the years 1920–36, driven in the last phase by political imperative, after which there was a period of overall policy stability towards the Reserve Bank and its expected functions. This – in general terms – matched the worldwide 'age of big government'; and while the specific New Zealand experience of the period can be considered ahead of the curve at times, it was otherwise broadly unexceptional.

6 Summary and conclusions

The debate over the origins of the Reserve Bank makes clear that the primary policy considerations were founded in the context of New Zealand's early twentieth century economic and banking history in general, and a response to immediate depression emergency in specific. In the context of the British push to get its Dominions to establish central banks, New Zealand's timing was unexceptional. Australia set up a central bank of sorts with the Commonwealth Bank as early as 1911; South Africa established a central bank in 1920, Canada matched New Zealand in 1934; and India followed in 1935.[107]

The ground moved markedly in the course of the period that is the focus of this article, broadly 1929–1936. Early in the period, orthodox advocates of the central bank, including The Treasury, saw it more as responding to longer-term pressures that were apparent prior to the depression. These included the long-standing case for a single New Zealand currency, established on a sound footing and independent both of Australia and of routine political pressure, supporting the exchange rate parity with the United Kingdom. An agency of this sort was seen as independent of political pressure, and able to put New Zealand's monetary management in a position where it was also independent of the situation across the Tasman.

While much of the immediate policy debate behind the 1933 legislation was conducted during the depression years, there is no evidence that a central bank was seen among Wellington policy makers as a sole or specific means of lifting New Zealand out of economic gloom. However, the depression did trigger a more activist approach to economic management in general, and in particular it led to a decisive departure from exchange-rate parity and to a nascent sense of exchange-rate policy.

Although post-dating the establishment of the Bank, the 1936 amendments must be considered an integral part of the process that led to New Zealand's decision to adopt a central bank in the first place, because the Labour party of Michael Joseph Savage considered the business unfinished, and proceeded to amend the control and function to suit its own more activist state-oriented vision when it came to power.

This highlights one historical issue. Niemeyer's advice to create a politically independent organisation was overtaken from the mid-1930s by the tides of general political, social and economic change, factors ultimately affecting parties of both left and right in New Zealand. Yet the notion was not forgotten. A considerable measure of operational independence, balanced by an extensive accountability regime, was finally achieved in the late 1980s, albeit amid a very different context from the one that had led to the Bank being opened in the early 1930s.

106 Greasley and Oxley, p. 716.
107 Singleton, p. 10.

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