

JFA. 4(1969)(1-19)

THE EDITOR'S GREETINGS

On November 22nd, 1969, the Royal University of Malta celebrated the completion of its Second Century since its foundation as a *STUDIUM GENERALE* by a decree signed by Grand Master Pinto on November 22, 1769. On November 23rd, a historic tablet commemorating this event was unveiled by His Royal Highness Prince Charles, in the presence of a distinguished audience including several representatives of foreign universities. On the very day these celebrations were concluded, the Royal University of Malta started its long adventurous journey through the dramatic 20th Century to its Third and many other centuries in the service of higher education and scholarship for the benefit of Maltese society in close fellowship and collaboration with the other universities of the world similarly engaged in the pursuit of knowledge and the promotion of the welfare of humanity.

We wish the Royal University of Malta a smooth, calm and successful journey through this and other centuries to attain the fulfilment of its historic mission and assignment as Malta's pyramid of higher education and the reservoir of the dynamic leadership of its Democracy. *QUOD EST IN VOTIS!*

The wording of the plaque unveiled by H. R. H.

ON THE 22nd NOVEMBER, 1769,
GRAND MASTER EMANUEL PINTO DE FONCECA
ACTING WITH THE AUTHORITY OF POPE CLEMENT XIV,
SET UP, IN PLACE OF THE JESUITS COLLEGE,
A PUBLIC UNIVERSITY OF GENERAL STUDIES,
IN VALLETTA.

THIS NEW CAMPUS
WAS BUILT TWO HUNDRED YEARS LATER
TO PROVIDE FOR THE FUTURE GROWTH AND NEEDS
OF THE ROYAL UNIVERSITY OF MALTA,
AND TO MARK THE OCCASION,
WAS INAUGURATED BY
HIS ROYAL HIGHNESS THE PRINCE OF WALES
ON THE 23rd NOVEMBER, 1969.

THE MALTA CURRENCY BOARD, 1949-68

By JOSEPH LICARI

The Central Bank of Malta Act (1967) lays down that the value of the reserve of external assets shall be not less than sixty per centum of the value of the Bank's notes and coins in circulation and of deposit liabilities of the Bank payable on demand. Compared with the relevant provisions of the Currency Notes Ordinance (1949) this breaks new ground in two important respects. In the first place the Malta Currency Board's only liabilities were currency notes in circulation: neither in its original form nor in any subsequent amendment did the Ordinance provide for the acceptance of deposits by the Currency Board from the commercial banks. Currency Boards were not intended to operate as bankers to the commercial banks but this function was not incompatible with the system itself. The East African Currency Board, for example, was reconstituted in 1960 and started to provide seasonal financing facilities for export crops with the dual aim of promoting exports and acting as a banker of last resort to the commercial banks. It also opened and maintained accounts for the commercial banks and introduced a multilateral clearing system. In order to act as a lender to the banking system in a period of scarce liquidity and to ensure the processing and marketing of crops, the Board was also given powers to discount and rediscount bills and other appropriate instruments issued in connection with the marketing of specified crops.¹ The Malta Currency Board, however, remained very much the same passive instrument that was instituted in 1949 and was not used as a deliberate precursor of the Central Bank.

The only change of consequence was made by the Currency Notes (Amendment) Ordinance of 1959 by which the Board was empowered to invest in Malta Government Stock. This was a departure from the rule of one hundred per cent minimum backing of liabilities by external assets; the rule was further relaxed by the Central Bank Act which lowered the minimum to sixty per cent. The second important principle introduced by the latter Act is the fact that the external reserve can be held in gold and any convertible foreign exchange instead of being tied exclusively to sterling. This study is primarily concerned with the vicissitudes of the Board's reserves from 1949 to 1968 and the story is summarised in Table 1. The reserves held by the Government Savings Bank, the National In-

TABLE 1

SUMMARY OF STATEMENTS ISSUED BY COMMISSIONERS OF CURRENCY FROM 1949 TO 1968

	(1) NOTES IN CIRCULATION IN £000	(2) NOTE SECURITY FUND IN £000	(3) EXTERNAL ASSETS IN NOTE SECURITY FUND IN £000	(4) INTERNAL ASSETS IN NOTE SECURITY FUND IN £000	(5) % OF 1	(6) 3 AS % OF 1	(7) LIQUID FUNDS IN £000	(8) 7 AS % OF 1	(9) U.K. BANK RATE ON DAY OF STATEMENT
1949	14,975	15,036	15,036	-	00.402	100.402	2,405	16.063	2%
1950	14,927	14,999	14,999	-	00.481	100.481	1,595	10.683	2%
1950	15,448	15,830	15,830	-	02.476	102.476	1,588	10.278	2%
1951	15,498	15,727	15,727	-	01.480	101.480	1,887	12.177	2%
1951	15,913	16,143	16,143	-	01.445	101.445	1,792	11.264	2%
1952	16,158	15,508	15,508	-	95.983	95.983	1,793	11.094	4%
1952	16,328	16,269	16,269	-	99.638	99.638	1,816	11.122	4%
1953	16,703	16,902	16,902	-	01.193	101.193	1,891	11.321	4%
1953	16,858	17,557	17,557	-	04.147	104.147	2,215	13.139	3½%
1954	16,758	17,491	17,491	-	04.377	104.377	1,805	10.774	3½%
1954	16,968	18,264	18,264	-	07.639	107.639	1,705	10.050	3%
1955	17,091	17,680	17,680	-	03.445	103.445	1,879	10.996	4½%
1955	17,821	17,498	17,498	-	98.190	98.190	2,040	11.446	4½%
1956	18,516	17,900	17,900	-	01.592	101.592	2,315	12.505	5½%
1956	19,278	19,057	19,057	-	98.856	98.856	3,473	18.016	5½%
1957	19,183	19,488	19,488	-	01.592	101.592	2,280	11.885	5%
1957	19,498	19,085	19,085	-	97.882	97.882	2,311	11.852	7%
1958	19,672	19,764	19,764	-	00.466	100.466	2,250	11.436	6%
1958	20,207	20,953	20,953	-	03.690	103.690	3,302	16.343	4½%
1959	20,317	21,425	21,425	-	05.452	105.452	2,747	13.520	4%
1959	20,747	21,919	21,919	-	05.647	105.647	4,903	23.631	4%
1960	20,582	21,565	20,480	1,086	04.777	99.504	4,335	21.062	5%
1960	21,597	22,483	21,399	1,084	04.104	99.084	5,245	24.283	6%
1961	22,292	23,233	21,225	2,109	04.222	95.214	5,112	22.933	5%
1961	23,172	23,884	21,780	2,103	03.071	93.994	4,343	18.743	7%
1962	23,541	24,840	21,336	3,505	05.520	90.632	3,414	14.503	5%
1962	24,097	26,922	23,436	3,486	111.723	97.257	4,373	18.146	4½%
1963	24,423	26,867	23,394	3,473	110.008	95.788	3,299	13.508	4%
1964	24,690	27,841	24,385	3,456	112.762	98.763	3,636	14.725	4%
1964	25,340	27,890	24,521	3,369	110.064	96.768	4,387	17.313	5%
1964	26,270	28,765	25,462	3,303	109.498	96.926	6,276	23.892	5%
1965	26,419	28,345	25,145	3,199	107.290	95.180	4,145	15.689	7%
1965	27,636	30,223	27,232	2,991	109.361	98.539	3,650	13.209	6%
1966	28,556	31,000	28,280	2,720	108.559	99.033	5,801	20.316	6%
1966	30,166	32,861	30,695	2,166	108.933	101.753	6,354	21.064	7%
1967	31,361	34,497	32,879	1,618	110.000	104.839	11,058	35.261	6%
1967	32,786	35,625	34,531	1,094	108.660	105.323	5,872	17.910	5½%
1968	34,271	36,905	36,159	746	107.686	105.509	5,765	16.822	7½%
7TH JUNE 1968	35,386	38,466	37,742	725	108.707	106.658	7,494	21.177	7½%

insurance Fund and the Treasury, though part of the official reserves, are not examined at all.

The functions of the Board are familiar from those of Currency Boards in other colonies. It issued on demand Malta currency notes to the equivalent value of sums in sterling lodged with the Board or with the Crown Agents in London. It also paid sterling through the Crown Agents to the equivalent amount of Malta currency notes lodged with the Board in Malta. The regulations later laid down that the minimum sum which could be transferred in this way was £5000. In theory everybody had access to the Board in Malta or to the Crown Agents in London but in practice banks were the only institutions to use this facility. Indeed it is believed that Barclays Bank D.C.O. was the only commercial bank in Malta which came into direct contact with the Currency Board at all regularly. Barclays' accounts for about one half of total deposits in Malta and the other banks (National Bank of Malta, Scicluna's and Tagliaferro's, but not the Bank for Industry, Commerce and Agriculture, Limited) transferred funds to and from London through their account with Barclays.

The Ordinance also established the Note Security Fund which held the equivalent value in sterling of all currency notes in circulation. The Fund was held by the Crown Agents and until the Ordinance was amended in 1959 it could be invested 'in securities of or guaranteed by the Government of any part of His Majesty's dominions (except the Government of the Island) or of any territory under His Majesty's protection which are quoted and dealt with on the London Stock Exchange or such securities as the said Crown Agents, with the approval of the Secretary of State (for the Colonies) may in their discretion select'. This particular provision was amended by Ordinance XVII of 1959. The Currency Board were additionally empowered in their discretion, 'to issue currency notes to the equivalent market value of securities of, or guaranteed by the Government of Malta'. However, the total amount of currency notes backed by these securities was at no time to exceed £3 million 'or such other sum as the Governor with the approval of the Secretary of State may from time to time prescribe' and in 1961 the sum was raised to £4m. In this way a fiduciary issue was for the first time sanctioned by law.

THE CURRENCY NOTE INCOME ACCOUNT

The Currency Board system had many drawbacks but was not without its redeeming features. It had at least one advantage over the pre-1939 situation when U.K. sterling was the only medium of circulation in Malta: the Board's external investments provided the Government with a regular source of income. Probably its only advantage over the set-up established

by the Central Bank Act of 1967 was its relative cheapness to administer.

The 1949 Ordinance opened an account called the 'Currency Note Income Account' which was to record the Currency Board's revenue and expenditure. The statements of account published by the Board at the end of each financial year from 1950 to 1968 are summarised in Table 2. The bulk of the income of this account was made up of 'dividends, interest or other revenues' derived from the Board's investments. Another source of income was the commission 'not exceeding one half per cent' paid to the Board for the issue and redemption of Maltese pounds. The other sources of income were insignificant and included refund of cable expenses and miscellaneous receipts.

In the pioneer Currency Boards the commission was fixed at a rate sufficient to pay for the expenses of the shipment of specie to and from the colony. The practice of charging a commission was retained into the era of the telegraphic transfer and it was rightly remarked² that 'the commission charged by the Authorities (became) not a necessary cost of operation, but a form of taxation'. The system itself afforded some scope for flexibility. In 1962, for example, the East African Currency Board which for sixteen years had been charging the standard rate of 1/4 per cent for both issues and redemptions, set the charge for buying sterling at 1/8 per cent and the charge for selling sterling at 3/8 per cent. The Board's aim was to discourage the outflow of funds from East Africa and to encourage the inflow of private investment capital from overseas and the repatriation of the country's export proceeds.

The East African Currency Board was unique in its manipulation of the commission: the Malta Currency Board was unique in the opposite direction because in fact it never charged a commission. The regulations fixed it at 1/4 per cent but whereas the charge had at least a historical justification in the case of those Boards which had come into existence in the age of the gold coin and the silver shilling it was completely gratuitous when the Malta Board was established in 1949. At this time Barclays had long been the Government's bank and apart from the other advantages which this entailed the Government was exempted from the usual bank charges. As a *quid pro quo* the Government agreed not to charge the commission on funds transferred by Barclays and the commission moneys which were received by the Currency Board were in fact paid by the Government. This, however, did not prevent Barclays from charging the commission on private transfers.

This situation seems to be uncommon, if not unique, in colonial currency arrangements. The branches of the Imperial banks were in effect similar to branches of a bank in the same country. The only friction which

THE CURRENCY NOTE INCOME ACCOUNT FROM 1949 TO 1968

TABLE 2

AT THE END OF MARCH	EXPENSES OF THE BOARD	AMOUNT EARMARKED FOR NSF-8(4)(II) (B) OF ORDINANCE	SURPLUS TRANSFERRED TO CONSOLIDATED REV. F. 8(4)(II) (B)	TOTAL	DIVIDENDS & INTEREST	COMMISSION	MISCELLANEOUS (INCLUDING RE- FUND OF CABLE EXPENSES
	£	£	£	£	£	£	£
1950	18,559	149,995	156,413	324,967	320,096	4,860	11
1951	25,832	157,273	206,624	389,729	387,941	1,775	14
1952	25,918	378,665	-	404,583	402,924	1,650	9
1953	13,789	169,021	274,778	457,589	454,414	3,163	12
1954	3,338	174,914	319,914	498,167	494,746	3,412	9
1955	9,661	176,797	316,915	503,373	501,663	1,708	3
1956	2,402	552,322	-	554,724	551,160	3,563	1
1957	2,096	194,883	511,767	708,745	704,769	3,967	9
1958	2,933	197,636	591,581	792,150	786,816	5,327	7
1959	2,804	214,247	598,633	815,683	813,317	2,363	4
1960	2,783	215,651	608,198	826,632	822,465	4,163	4
1961	2,467	232,332	714,564	949,363	940,834	8,525	4
1962	28,404	248,404	941,951	1,218,759	1,202,128	16,623	8
1963	17,560	-	1,224,440	1,242,000	1,228,287	13,705	8
1964	2,320	-	1,278,478	1,280,798	1,268,924	11,873	1
1965	3,002	283,448	1,097,694	1,384,144	1,374,637	9,503	4
1966	2,460	310,000	1,167,616	1,480,076	1,467,428	12,643	5
1967	9,715	-	1,713,496	1,723,211	1,708,946	14,263	4
1968	9,625	369,052	1,554,907	1,933,584	1,908,328	25,250	6
JUNE 1968	3,965	380,860	379,891	764,727	758,084	6,638	5

prevented funds from being transferred between London and the colonies as easily as between regions of the same country was exactly the commission which was charged on the transfer of funds. Once Barclays was exempted from these payments it could transfer sterling to and from Head office as easily and inexpensively as it used to do before 1939. The commission which appears in the Currency Board's Income Account is an index of the traffic of funds between London and Malta but never operated as a restraint on the commercial banks. One of the effects of the commission in other territories was that it imposed a charge of one-half of one per cent on the round-trip: this tended to lock up in the territory a larger volume of idle balances than the commercial banks thought necessary. This was the case especially before 1952 when interest rates were low and it was unremunerative for banks to transfer funds to the London money market unless they could spare it for a longish period. The Malta branch of Barclays D.C.O. laboured under no such restraint.

As for the expenditure side of the Currency Note Income Account, the first charge was 'all the expenses incurred by the Board and the Crown Agents in the preparation, transport and issue of currency notes and the transactions of business relating thereto'. Throughout the twenty years that the Board was in operation in Malta its total costs of administration were less than £200,000. In ordinary years the expenses were around £3000 and included about £2,400 for salaries and allowances, small amounts varying between £30 and £200 (usually much nearer the lower than the upper end of the range) for incidental expenses. Occasionally there were extraordinary expenses of a technical nature: construction of a strong room (£3000) in 1950, purchase of a perforating machine (£120) in 1952, purchase of a bank note counting machine (£600) in 1961, purchase of a note cancelling machine (£900) in 1962 and the construction of an incinerator room (£400) in 1965. The major expenses which were incurred from time to time were for the printing of notes and, in the first years, for the repatriation of Bank of England notes. In the first four years these two items accounted for about £70,000. New currency notes (which for the first time included five pound notes) were issued in 1963 and their printing cost about £40,000 during the previous two years. The reprinting of currency notes cost about £13,000 between 1966 and 1968.

Taking one year with another the expenses of the Board were of the same order as the 'income' from commissions. So the income from dividends on investment and interest on sums deposited with the Joint Colonial Fund (Joint Consolidated Fund since 1957) was practically a net profit. Of this 'a sum equal to one per centum of the amount of the Fund, that is to say, the amount made up of the liquid moneys of the Fund to-

gether with the estimated market value of the investments in the Fund on the last day of each financial year' was to be paid annually into the Fund until the amount of the Fund reaches 110 per cent of the currency liabilities'. The surplus over one per cent, if any, was paid into the Consolidated Revenue Fund. This involved a departure from the strict letter of the constitution.³ The self-government constitution which was introduced in 1947 and suspended in 1958 set up a dyarchical system of government: the Maltese elected assembly was responsible for legislation but there were certain 'reserved matters' which were the province of the British Governor. One of the reserved matters was 'coinage and currency', hence the Currency Notes Ordinance itself was enacted 'by the Governor of Malta by virtue of the powers conferred upon him by the Malta (Office of Governor) Letters Patent, 1947'. Another reserved matter was 'the appropriation of any such revenues as may accrue in respect of any reserved matter'. So strictly speaking the income of the N.S.F. could not be transferred to the Consolidated Revenue Fund because the latter included all revenue 'over which the (Legislative) Assembly has power of appropriation'. But the Currency Notes Ordinance saw to it that this situation was regularised.

In some other Currency Boards the Note Security Fund had to reach the 110% mark before it started transferring the surplus to the Government's budget. In Malta's case such a provision would have meant that the Fund's contribution to the Government's revenue would have been nil in the first few years when the Fund was slowly climbing to the prescribed ceiling. This would in turn have implied a concentration of the Fund's payments in the later years of its life. As it was the N.S.F. failed to make a contribution to the Consolidated Revenue Fund in only two years during these two decades. In 1952, following the rise in British bank rate, the value of the Board's investments fell from £14.35 million to £13.72 million, a drop of 4.4%. This brought the currency backing to below 100 per cent for the first time and in these circumstances the Board was bound by law to devote all its income to the Fund's replenishment. During the financial year 1955/56 Bank rate rose from 4½% to 5½%. The accompanying fall in the value of the Fund's investments coincided with an increase in currency liabilities from £17.1m. in March 1955 to £18.6m. in March 1956. Consequently the ratio of external assets to currency liabilities fell from 103.4 to 96.7 per cent during the same period. The Board devoted over half a million pounds, the highest sum ever, to replenishing the N.S.F., and for the second and last time in the Board's history the Government had to go without the by now expected contribution from the Board.

The Ordinance stated that any surplus over one per cent 'shall be transferred to the Consolidated Revenue Fund' and that 'any deficiency in the Account (on the last day of the financial year) shall be met from moneys to be appropriated out of the said Consolidated Funds'. The deficiency refers to the eventuality of the N.S.F. falling below 100 per cent. However, on the two occasions that it did no transfers were made. The deficiency was known to be temporary and the island's resources were not burdened by transferring monies from the Government's current revenue. In the immediate post-war period the necessity and advisability by the 100 per cent rule began to be increasingly doubted. Indeed when the second 'deficiency' occurred the Colonial Secretary had already relaxed the rule, even though no specific legislation was passed in Malta before the 1959 amendment.

The Ordinance also contemplated the possibility of the amount of the N.S.F. exceeding 110 per cent of the face value of the notes in circulation. If at the end of any financial year this was the case the Governor, with the sanction of the Secretary of State, could direct:

- (i) 'that the whole or part of the excess over the 110 per centum shall be transferred from the Fund to the Consolidated Fund; and
- (ii) that the annual appropriation out of the Currency Note Income Account of the 1 per centum aforesaid shall be wholly or partially discontinued for so long as it shall appear that the necessity for such annual appropriation no longer exists'.

Neither the Ordinance nor any subsequent amendment distinguished between total reserves and external reserves as far as the 110 per cent ceiling was concerned. In fact this ceiling was reached with the help of Malta Government Stock at the end of three financial years, 1962/63, 1963/64, and 1964/65. In these years practically the whole of income from dividends and interest was transferred to the Consolidated Fund.

During the two decades under review the contribution of the N.S.F. to the Consolidated Fund rose both in absolute and in relative terms (See Table 3). From the financial year 1959/60 onwards, however, we have to distinguish between the N.S.F.'s gross and net contribution to the Consolidated Fund. In 1960 the Currency Board started to hold Malta Government stock as well as foreign securities, so part of its investment income originated from the Malta Government itself and the Government can be said to have received this income in an accounting rather than in any real sense. In the last five years before the enactment of the 1949 Ordinance revenue from the N.S.F. as a percentage of total revenue averaged 6.43% and the figure of 8.2% which was reached in 1944/45 was never to be equalled. The high ratios, however, were due to the low level of govern-

THE NOTE SECURITY FUND'S CONTRIBUTION TO
GOVERNMENT'S REVENUE

TABLE 3

FINANCIAL YEAR	(1) GOVERNMENT'S TOTAL REVENUE IN £000	(2) REVENUE FROM N.S.F. IN £000	(3) ESTIMATED NET* REVENUE FROM N.S.F. IN £000	(4) 2 AS % OF 1	(5) 3 AS % OF 1
1944/45	3,380	278	.	8.2	-
45/46	4,007	293	.	7.3	-
46/47	4,891	300	.	6.1	-
47/48	5,234	275	.	5.3	-
48/49	5,309	278	.	5.2	-
49/50	5,557	156	.	2.8	-
50/51	5,720	207	.	3.6	-
51/52	6,147	-	.	0.0	-
52/53	7,851	275	.	3.5	-
53/54	7,695	320	.	4.2	-
54/55	8,202	317	.	3.9	-
55/56	9,835	-	.	0.0	-
56/57	11,988	512	.	4.3	-
57/58	13,406	592	.	4.4	-
58/59	12,836	599	.	4.7	-
59/60	14,944	608	592	4.1	4.0
60/61	16,396	715	619	4.4	3.8
61/62	16,814	942	774	5.6	4.6
62/63	16,572	1,224	1,017	7.4	6.1
63/64	16,687	1,278	1,074	7.7	6.4
64/65	18,626	1,098	903	5.9	4.8
65/66	19,797	1,168	996	5.9	5.0
66/67	22,726	1,713	1,600	7.5	7.0
67/68	24,379	1,555	1,500	6.4	6.2

* The figures in this column are derived by subtracting from column (2) the estimated revenue to the N.S.F. from its holdings of Malta Government Stock.

ment revenue (and expenditure) in the 1940's compared to the 1950's and 1960's.

The four years from 1949/50 to 1952/53 include the last stages of the cheap money policy in Britain, and the rise in Bank rate to 4% in March 1952. During these four financial years the N.S.F.'s contribution was equivalent to 2.5% of the Government's total revenue. In the period from April 1st 1953 to 31st March 1961 the N.S.F.'s net contribution hovered around the 4% mark. The average for the eight years was 3.6%. The period from April 1961 onwards was one of high interest in rates the U.K.; the

N.S.F.'s net contribution to the Government's revenue was higher and reached 7 per cent in 1966/67.

INTERNAL AND EXTERNAL RESERVES

The investment of the N.S.F. in Malta Government Stock was a rather retarded result of a change of policy in Whitehall. In December 1954 the U.K. Secretary of State for the Colonies stated that he had recently advised the colonial governments that 'subject to a review of the individual circumstances of each territory, I would agree in principle to the investment of a small part of the cover for Colonial currencies in locally issued securities. The currencies would still be fully backed and automatically redeemable for sterling. It is not the intention to go beyond this'.⁴ This power was not utilised in Malta until 1959 and it cannot be ascertained whether this was a deliberate policy decision taken after 'a review of the individual circumstances of (the) territory' or just a result of inertia. In all probability the question never arose.

The primary purpose of introducing fiduciary powers was to make part of the external currency backing available for currency expenditure at a time when traditional sources of investment money had become scarce.⁵ In Malta the opposite happened. Largely for political reasons the inflow of development capital from the British government increased from £2.4m. in 1954 to £6.2m. in 1957 and during the period 1955-1958 when the Malta Labour Party was in office it totalled £20.4m. The suspension of the self-government constitution in 1958 and the advent of direct rule by the British Governor ushered in a period of relative stringency in the flow of British official capital to Malta.

The Local Development Stock Ordinance (1959) marked the first attempt by the Government to tap local resources for development purposes. In December 1959 the first issue was made: £1,300,000 of Local Development Stock at 6% was issued but given the political uncertainty of the time, and in spite of the general state of liquidity of the economy, the issue was unsuccessful. A fortnight before, however, the Currency Notes Ordinance of 1949 had been amended to allow the Currency Board to invest in local securities. The Board's return for March 1960 showed that it had absorbed no less than £1,086,000m. of Malta Government Stock. The second issue, of £1,200,000, was made in October 1960 but it does not seem to have been any more popular with the public; the following March the Currency Board's holdings of Malta Government Stock had risen by over £1m. The same fate, apparently, met the third issue, the last one by a Colonial Government, which was made in November 1961. The evidence does not indicate that the authorities expected the issue to be

more successful than its predecessors for in the same month the legal maximum of local securities which the Currency Board could hold was raised from £3m. to £4m. The expectations, if not the hopes, of the Government were justified: £1,670,000 of Local Development Stock was offered for public subscription but by March 1962 the Currency Board had increased its holdings of local stock by £1.4m. to a total of £3.5m.

The next two or three years were a time of political flux. A Maltese elected government was sworn into office in February 1962 and the Island became independent in September 1964. Apart from the uncertainty which such an event inevitably involves, independence was actually opposed by a small but highly vocal political party on the grounds that it would bring about the depreciation of the Malta pound to 9s.2d. sterling. This state of affairs, coupled with the lack of response with which previous issues of local securities had been met, did not encourage the issue of any local stock. The first issue made during the term of office of a Maltese elected government was in March 1965, a few months after independence. The caution with which the matter was approached is obvious from the fact that the issue was relatively small, £0.5m., and the interest rate slightly higher than previous issues: 6½ instead of 6 per cent. The issue was fully subscribed within two days and this set the pattern of things to come. In March 1966 stock to the value of £0.75m. at 6½ per cent was taken up within hours. The popularity of the stock was taken advantage of in 1967 and 1968: in each year £0.85m. were issued and the interest rate was put at 6 per cent, in spite of the fact that interest rates in Malta and in the United Kingdom were on a rising trend. This meant that between 1965 and 1968 the Currency Board was not called upon to take any Malta Government Stock. Indeed it took advantage of the state of the market to unload the stock it had taken up between 1959 and 1961. The Board's holdings of Malta Government Stock showed a strong declining trend from 1965 onwards and fell from £3.3m. in September 1964 to £0.7m. on the date of the handing over of the Note Security Fund to the Central Bank of Malta.

It seems that the Maltese elected government regarded the investment of the Currency Board's funds in local stock as a necessary, but by no means desirable departure from financial orthodoxy. No doubt as long as other local sources of liquid funds are available the necessity of diverting official reserves towards development may not be so urgent. However, it is ironical that in Malta the change in policy towards the official reserves should have happened under a regime which, from the constitutional and political points of view, was most 'colonial'. In fact most of the criticism of the '100 per cent external backing' rule had come from economists who had criticised the 'colonial' practice of enforcing a system which had a

built-in deflationary bias and it was as a result of these criticisms that the rule was relaxed.

As far as the fiduciary issue of the Malta Currency Board is concerned it will be noticed that the two amending Ordinances established the ceiling in terms of absolute sums (of three and four million pounds respectively) rather than in terms of percentages of currency liabilities. The first Currency Board to be empowered to make a local fiduciary issue was that of Southern Rhodesia.⁶ In 1947 a local act placed the Southern Rhodesian Currency Board under an obligation to invest not more than a total of 20% of its Currency Fund in local registered government stocks if required to do so by any one of the three governments for which it acted (namely those of Southern Rhodesia, Northern Rhodesia and Nyasaland). Therefore if there had ever been a sharp fall in currency circulation the Board would have been obliged to unload its local securities to avoid the possibility of its local asset ratio's ever rising above 20%. This would not have been disastrous in Southern Rhodesia because a local money market of some sort has long been in existence, but securities had only a limited marketability in those colonies (including Malta) which were at an earlier stage of financial development. In these instances the limit to the fiduciary issue was set as a fixed sum in order to avoid possible embarrassment to the Board in the event of a sharp fall in currency circulation. It is recognised⁵ that when the operation consists only of taking up long-term internal securities of government, as it was in Malta from 1960 to 1968, the benefit to the economy is limited and largely of a once-for-all nature. For having once acquired long-term and unmarketable securities a currency board tends to revert to a position of automaticity. Continued flexibility in operation requires two things. First the retention of an unused margin of fiduciary powers for emergencies; secondly, operations in marketable or self-liquidating assets which can be used to cushion fluctuations in local credit conditions. The second function was never utilised by the Malta Currency Board; indeed it was not empowered to enter into such operations. However the advisability of retaining a constant margin of unused fiduciary powers was recognised and acted upon and in any case the limit to the fiduciary issue could always be changed by law.

Expressed as a percentage of currency liabilities the fiduciary issue never exceeded ten per cent. Indeed by September 1966 the external reserve had climbed back to over one hundred per cent where it has stayed to date. Under the Ordinance the Board was bound to retain and reinvest its income up to a maximum of one per cent of the Note Security Fund each year until the Fund provided 110% backing to the currency liabilities. The Board's first statement, issued in September 1949 revealed a backing of just over 100 per cent. Between September 1951 and March 1952 the

backing fell from over 101% to 96%. This was a result of the rise in the Bank of England's discount rate from 2½% to 4% in March 1952. So in 1952 the Board made its first, unannounced, fiduciary issue. By 1953 however the Board could again boast of a sterling cover of over 100 per cent until in September 1954 the external reserves reached the all-time peak of 107.6 per cent. In September 1955, however, the Board once again fell from grace and the five statements made between then and September 1957 show the Board 'in the red' on four occasions with an average fiduciary issue of about 2 per cent. These fluctuations were a result of the increase in the U.K. Bank rate at the same time that the volume of notes in circulation in Malta was expanding. It was only in March 1960, after the enabling amendment of 1959 that the Board started to invest in Malta Government Stock and therefore to make the fiduciary issue a part of its policy. Even so the percentage of unbacked currency liabilities was never to come anywhere near the 40 per cent which was later sanctioned by the Central Bank Act of 1967; between March 1960 and March 1966 it averaged 3.33%. September 1966 again saw the Fund 'in the black' and when the Fund's assets were transferred to the Central Bank the external reserve stood at 106.7 per cent, the second highest recorded level.

During the period of Crown Colony rule the ratio of external reserves to currency liabilities was allowed to fall from 105.6 per cent in September 1959 to 90.6 per cent in March 1962. But the election of a Maltese representative government in February 1962 marked the return of financial orthodoxy: the ratio of external reserves to demand liabilities approached the 100 per cent level until they exceeded it in September 1966. By the time the Central Bank Act came into force the Currency Board had not made a fiduciary issue for over two years.

The Central Bank Act lays down that the value of the reserve of external assets shall be 'not less than sixty per centum' of the value of the Bank's demand liabilities. In the first place it is significant that the ceiling of the fiduciary issue is expressed as a percentage and not as an absolute sum as it was under the Currency Notes Ordinance after it was amended. Secondly, it would be interesting to know how the figure was arrived at. In 1951 I.M.F. advisers reported on the unification of the currency in Libya.⁷ One of their recommendations was 'that reserves of 100 per cent in foreign exchange be maintained for the new Libyan currency'. In their opinion this policy was to be combined with foreign borrowing and they envisaged the possibility of the reserves themselves being pledged as security. The reasons they brought forward to justify their advice, however, seem to beg the question of the necessity of a one hundred per cent backing of demand liabilities by external reserves: with homely wisdom they opined that 'there is far more incentive to sound

monetary policy from the pressures to repay a loan than from the pressure to reconstitute reserves once these reserves have been depleted'. On the other hand Newlyn and Rowan in a study of British Colonial Africa⁸ indicated that a reserve of 50 per cent of the currency, or perhaps even less would be 'perfectly adequate for the maintenance of convertibility'. In between the two extremes Dr. Greaves has expressed the view that 'to reduce the sterling counterpart funds by anything like 50 per cent would be to take a great risk' and indicated that reserves of about 66 per cent is probably the minimum amount that can be held with safety. Dr. Birnbaum, in a study of the subject,⁹ declares that his own conclusions do not differ much from those of Dr. Greaves, but cautions that the special characteristics of the economy should be studied carefully before deciding the requirements of foreign exchange assets in any particular case. He remarks that countries with a high propensity to import might find it impossible to release any of their holdings of foreign assets immobilised as currency cover when they move from an automatic to a discretionary currency-system. 'Impossible' is too strong a word: Malta's external reserves were down to 91 per cent in March 1962 when imports were running at just over 60 per cent of the G.N.P. However, the difficulty of running down the external reserve should not be underestimated in a country where due to the development exercise the propensity to import has been on a rising trend: during the decade 1954 to 1963 imports as a proportion of G.N.P. averaged about 64 per cent, but between 1964 and 1967 they averaged about 70 per cent. One thing is certain: the ratio of external reserves to demand liabilities will not fall anywhere near the sixty per cent floor in the near future, and this view was confirmed in the first issue of the Central Bank of Malta, Quarterly Review.¹⁰ In spite of this the strategy of advance has already been mapped out in some detail. It is established that the Bank may 'purchase and sell publicly issued securities of or guaranteed by the Government maturing is not more than 20 years' and subscribe to, purchase, and sell shares or debentures of any corporation established by law or sponsored by, or set up under the authority of, the Government for the purpose of promoting or financing development in Malta or for the purpose of promoting the development of a money market or a securities market in Malta'. The Malta Development Corporation Act (1967) enables the Corporation to borrow such sums as it may require for the purpose of meeting its obligations and to issue debentures, debenture stock or other securities (Section 11). Section 12 further empowers the Minister responsible for finance to guarantee on behalf of the Government the repayment of the principal of, and the payment of interest and other charges on, any authorized borrowings of the Corporation. It is not difficult to predict how these two provisions will link up the Bank's reserve

policy and its policy towards the economic development of the Island.

LIQUID ASSETS

The Currency Notes Ordinance laid down that the selection of securities was to be left to the discretion of the Crown Agents with the approval of the Secretary of State for the Colonies; however, a proviso was made that 'the Governor may issue directions to the Crown Agents as to the amount of the Fund to be held in liquid form'. Ordinance XVII of 1959 reworded this requirement but made no significant change in substance. The provision now read 'a proportion of the Fund shall be held in liquid form and such proportion may be determined and varied from time to time by the Governor in directions (the issue of which is hereby authorized) to the Crown Agents'. These provisions were appropriately amended when the island became independent in 1964. From the Fund's institution till March 1956 the liquid portion consisted entirely of funds deposited at call in the Joint Colonial Fund. The ratio of liquid assets to currency liabilities varied between 16 per cent in the first statement and 10 per cent in 1954 but taking one year with another it hovered around the 11 per cent mark during this first period.

In September 1956 the Board invested part of the net increase of just over £1m. of the Fund in Treasury Bills. U.K. Treasury Bills figure among the NSF's assets till March 1965: indeed throughout the nine years the sum remained constant at £1m. so the Board does not seem to have worked to any pre-determined ratio of Treasury Bills to money at call or to currency liabilities. However, the availability of these short term securities did permit the Fund to lower its ratio of money at call, at least between September 1956 and March 1959. During these three years the ratio of money at call to currency liabilities varied between 13 and 6 per cent. As was to be expected, however, the overall ratio of liquid assets (money at call plus Treasury Bills) to currency liabilities was on average higher than in the previous period and varied between 18 and 11.5 per cent. Between March and September 1959 the funds deposited at call in the Joint Consolidated Fund jumped from £1.75m. to £3.90m. and, as a proportion of currency liabilities, from 8.6 to 18.8 per cent. The reasons for this switch in policy can only be guessed: it may be that the Colonial Government of the time decided to minimise the risks accompanying the repatriation of reserves by raising the total liquid assets ratio close to 25 per cent and the ratio of money at call to almost 19 per cent. Perhaps a more likely reason is that the Board kept a greater part of its resources in liquid form because it could be and in fact was called upon to invest in local securities at rather short notice. These ratios remained at these

high levels till September 1961; by that time it seems that those in authority felt sure that a breakdown in confidence was no longer a plausible possibility. When, following the amending Ordinance of 1961, the Board raised its holdings of Malta Government Stock from £2.1m. in September 1961 to £3.5m. in March 1962 the level of long term U.K. and Commonwealth investments rose as well (by £9.5m.) and it was the funds deposited at call that were run down from 14.4 to 10.2 per cent of the Board's currency liabilities. In any case during this period interest rates in the U.K. were high and the interest rate differential between long-term securities and money at call was therefore less of a consideration.

The Currency Board's statement of March 1967 repays careful examination. Liquid assets as a proportion of currency liabilities reached 35.2 per cent, eleven percentage points higher than they had ever been, and about two-thirds of the liquid assets were funds deposited at call. The big increase was due in large measure to the fact that £3.3 million which had been invested in March 1966 in Joint Consolidated Fund deposits maturing in March 1967 were allowed to mature without any 'rolling' arrangements having been made. At the time Malta was faced with a highly critical situation as a result of the decision by the British Government, foreshadowed in the 1966-67 Defence Review, to reduce its defence expenditure in Malta. This led to a crisis of confidence between the Maltese and the British Governments and *The Economist*¹¹ referred to rumours that Malta might decide to switch part of its sterling balances to other financial centres. A compromise solution on the rundown of British forces was eventually reached. The return published by the Currency Board for September 1967 shows that total liquid assets were down to 17.9 per cent of notes in circulation and the ratio of money deposited at call had dropped to 5.7 per cent of demand liabilities. It was explained in the House of Representatives that owing to exceptionally high short-term interest rates in London at the time the Currency Board was able to maintain extra liquidity during the crisis period without sacrificing current earnings.

THE FINALE

The Central Bank of Malta Act was passed by the House of Representatives on the 8th November, 1967 but came into force only on the 17th April, 1968. So when sterling was devalued on 18th November, 1967 the parity of the Maltese pound was automatically adjusted downwards in accordance with section 6 of the 1949 Ordinance which laid down that Maltese currency notes should be exchanged 'at the rate of one pound for one pound sterling'. The Maltese Parliament could, of course, have amended the 1949 Ordinance if it had wanted to retain the previous dollar value

of the Malta pound, so that far from being automatic the devaluation of the Maltese currency was very much a deliberate decision arrived at in Malta.

During the international monetary crisis of early 1968 several currencies came under attack. This time it was felt that should Britain be forced to devalue Malta should not necessarily follow suit. On the 17th March 1968 the House of Representatives met to pass 'an Act further to amend the Currency Notes Ordinance 1949'. The main provision of the 1968 Amendment was that immediately after the words 'at the rate of one pound for one pound sterling' in the Ordinance there should be inserted the words 'or at such other rate as the Minister responsible for finance, with the consent of the Prime Minister, may from time to time fix by notice published at the Treasury'. The Minister was further empowered to suspend the operation of all or any part of section 6 of the 1949 Ordinance which ensured the convertibility of Maltese pounds into sterling and vice-versa.

Thus, in the fourth year after independence and just a month before the launching of the Central Bank was the umbilical cord which tied the Maltese pound to sterling severed in the midst of an international monetary crisis and one of the essential characteristics of the Currency Board system was abandoned. One of the main advantages of the system was that colonial currencies were freely convertible into sterling and the rules of the game ensured that they were, in a very real sense, as good as the mother currency. But just before the Malta Currency Board was wound up the Maltese government took preventive measures to protect the island's currency against sterling. The move was an index of two important developments. The relationship between Malta and Britain was undergoing a sea-change and the role of sterling in the world was undergoing a complete transformation. Later on in the year the world's leading central bankers reached agreement on the 'Basle Facility' by means of which the dollar value of the bulk of the official sterling assets of overseas sterling area countries was guaranteed. The British government described this as 'a milestone in the evolution of the Sterling Area and a major contribution to world monetary stability'.¹² The Governor of the Deutsch Bundesbank said the arrangement was a 'scheme for the gradual and controlled withdrawal of sterling from its reserve role'. But by then the Malta Currency Board was a thing of the past and the Central Bank was the organ responsible for seeing the country through these developments.

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²Greaves, Ida, Colonial Monetary Conditions, London, H.M.S.O., 1953.

³Shannon, H.A., The Modern Colonial Exchange Standard, IMF Staff Papers, April 1952.

⁴House of Commons, Weekly Hansard, London, 15th December 1954, Written Answers to Questions, column 143, quoted in Birnbaum, E.A., The Cost of a Foreign Exchange Standard, IMF Staff Papers, February 1957.

⁵Currency and Banking in the Commonwealth during the past ten years, Bank of England Quarterly Bulletin, March 1962.

⁶Monetary Systems of the Colonies, The Banker, monthly articles from July 1948 to February 1949.

⁷Blowers and McLeod, Currency Unification in Libya, IMF Staff Papers, November 1952.

⁸Newlyn, W.T., and Rowan, D.C., Money and banking in British Colonial Africa, O.U.P., London 1954.

⁹See footnote 4.

¹⁰Currency and Coin in Malta, Central Bank of Malta, Quarterly Review, September 1968.

¹¹The Economist, 11th February, 1967.

¹²See the White Paper, 'The Basle Facility and the Sterling Area', published in October 1968, H.M.S.O., Cmd 3787.