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NEW RESTRICTIONS ON INSTALLMENT CREDIT IN THE UNITED KINGDOM Samuel I. Katz

Since the restoration of an effective monetary policy in November 1951, the British authorities have undertaken special measures to curtail the volume of "hire purchase" or installment credit. In December, the London clearing banks were requested by the Treasury to ensure that finance for hire-purchase should be limited. At the end of January, the Chancellor introduced more stringent restrictions over the terms of credit-sale contracts as a major method of limiting the volume of installment credit and of curtailing demand for goods produced by the metal-using and engineering industries so that capacity could be freed for export and defense needs. These measures represent more significant restraints on hire purchase credit than have ever been applicable in Britain. The lack of organised statistics makes it impossible to measure the effectiveness of these steps or even to approximate the volume of credit outstanding.

Types of installment credit

Installment financing grew rapidly in Britain during the inter-war period in response to the need for specialised credit facilities for the financing of consumer and certain types of capital goods. Though reluctant to allocate their own resources and to undertake the administrative effort involved in credit selling, manufacturers and retailers gradually moved into the business in the interest of increasing turnover. Out of the growing demand for this type of financing arose an increased participation of specialised financial institutions which had been organised, or had expanded from small beginnings, to perform this function.

The encouragement given by the monetary authorities to develop adequate installment credit facilities was an important factor in the rapid growth of installment financing before World War II. The Bank of England's assistance took the concrete form of purchasing in 1930 over £260,000 of shares in the most important of the private hire-purchase firms. 1/ Once the position of the hire-purchase firms in the London money market had been established on a stable footing, the Bank withdrew from active participation by selling its interest to the common stockholders in 1936 and 1937.

Various methods have been employed to finance hire-purchase operations. Some firms have been financed by insurance companies which have a direct financial interest in them; in the case of American corporations operating in Britain, the parent company often provides the necessary capital for the

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1/ T. Balogh, Studies in Financial Organisation (Cambridge, 1947), p. 159.

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British subsidiary. Clearing banks provide funds in the form of bank advances and the London acceptance houses extend credit in the form of acceptance credits. In the case of acceptance financing, the hire-purchase finance firm may discount for the retailer a group of hire-purchase or credit-sale agreements made with his customers; this underlying paper can then be used by the finance company to secure its own drawing on a London acceptance house under an acceptance credit. The paper is then discountable in the money market, since it is "clean" and bears a first-class name in addition to that of the finance house itself. 1/ Under a second kind of arrangement, the retailers may sell the goods themselves to the finance concern which then assumes the responsibility for the collections.

Installment financing is available for consumer and capital goods in Britain; finance houses themselves specialise in providing facilities for industrial and agricultural equipment and also finance a significant volume of consumer goods. Traders at all stages of distribution also provide installment credit from their own resources and from their lines of credit from the banking system. Over 100 finance houses are members of the Hire-Purchase Trade Association, and there are a large number of non-member institutions.

The Financial Times has reported that the terms of the finance companies are generally similar. 2/ For smaller transactions, a flat rate of about 7 per cent applies although a 5-per cent rate is in effect for transactions above £ 10,000. For the individual buyer, the charges vary according to the goods, the terms of sale, and the risk factor. Where collectors are employed, the retailer may place up to a 25-per cent service charge. But some retail financing, with little labor or risk, is done at as little as a 5 per cent rate.

Recent growth in installment credit

Installment selling has grown rapidly in the United Kingdom, particularly during the last two years, in the fields of consumer durables and in specialised business equipment. Even before the war, this type of financing was important for automobile sales. It has been estimated that, as early as 1928, about 80 per cent of passenger cars, 50 per cent of all trucks, 40 per cent of all buses and 75 per cent of all taxis were sold on the installment plan. Within the recent past, The Banker has estimated that in the furniture,

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1/ Harold Cowen, "Changes in Hire-purchase Finance", The Banker, February 1948, p. 95.

2/ "Hire Purchase and its Finance", The Financial Times, October 19, 1951, p. 4.

cycle, radio and household appliance trades especially, the value of the hire-purchase business had increased by anything from 50 per cent to 100 per cent within a period covering the past two years. 1/ The Economist has estimated that 75-80 per cent of all furniture sales, about half of all radio sets and over a third of television sales are financed in this way. There has also been "a rapid growth, during and since the war, of installment selling in the field of producer goods, embracing all kinds of industrial and agricultural equipment". 2/

The fragmentary statistics available confirm a recent expansion in hire-purchase trading. For example, between 1948 and 1950, the portfolios of the six principal finance houses have expanded from £27 million to £33 million (current assets minus cash and investments), a rise of 23 per cent. An even more considerable increase occurred in borrowings by these houses: the total of bank loans, acceptances and deposits rose from nearly £20 million to £27 million, a 38-per cent expansion.

Turning to retail traders, bank loans to retailers have risen from £131 million in February 1948 to a peak of £205 million in February 1952, according to quarterly estimates of the British Bankers Association; by August 1952, however, the total had declined to £176 million. Since retailers draw upon their own resources and upon borrowed funds to finance their own credit sales, it is probable that a significant portion of these retail loans have contributed, directly or indirectly, to hire-purchase selling. Further evidence of this recent growth is pointed to by The Economist which indicates that a major retail selling chain shows a rise in hire-purchase assets from £16 million on March 31, 1949 to £28 million on the same date in 1951.

Operations of both the nationalised electricity and gas industries have also contributed to the increase in installment credit. Reports of the British Electricity Authority show that their hire-purchase sales rose from £1.7 million during 1948-49 and £5.2 million in 1949-50 to £9.7 million during 1950-51; hire-purchase transactions accounted for only 10 per cent of total sales in the earlier year but amounted to 37 per cent in 1950-51. Similarly, sales of gas appliances by the British Gas Council rose from £8.3 million during the 11 months of 1949-50 to £14.6 million during the 12 months ending March 1951, while the percentage of total sales accounted for by hire-purchase trading rose from 49 per cent to 63 per cent.

1/ The Banker, January 1952, p. 38.
2/ The Economist, December 29, 1951, p. 1592.

Control over installment credit

The recent growth in installment finance has taken place in the face of repeated official discouragement. The authorities have relied upon two separate methods to limit the volume of this credit: control over the terms of individual hire-purchase contracts and restrictions on bank credit for hire-purchase purposes.

Wartime regulation over credit terms of hire-purchase contracts was introduced by the British Government in 1941 in connection with the administration of price control; throughout the war, this approach was used to limit credit purchases of scarce consumer goods. Unless specific provision was made in the Board of Trade's price control order, service charges for time-purchases were legal only to the extent that the authorised maximum price was not exceeded. In 1943, this indirect restriction of credit was replaced by a prohibition of hire-purchase trading under Defense Regulations except where specific exception was authorised by the Government. The initial exceptions included all goods covered by price control orders which made specific provision for credit charges; in addition, there was a list of specified products. 1/ After the war ended, additional commodities were added to the list of exceptions. 2/ In June 1947, however, the over-all prohibition was revoked and restrictions over hire-purchase once again became ancillary to the price control administration. Covering mainly price-controlled consumer durable products, the regulations required a minimum down-payment of not less than 12-1/2 per cent, fixed the duration of the credit from 9 months to two years and stipulated a maximum interest or service charge at 20 per cent.

Since the end of the war, the monetary authorities have tried to restrain the volume of bank credit for hire-purchase trading by means of direct appeals to the commercial banks and finance houses in the London money market and through control over capital issues. In May 1945, the initial directive establishing the Capital Issues Committee stipulated that new issues of hire-purchase firms would be allowed only where it was

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1/ The Banker, op. cit., page 98. The specific products included: motor cycles and accessories (including tires), pedal cycles and tricycles, sewing machines, carpets and other floor coverings, radio sets, domestic cooking appliances and hearing aids.

2/ The products added included: water softerners, refrigerators, gramophones, musical instruments, cash registers, office machinery, hand tool kits, and hairwaving machines.

established, through consultation with government departments, that the facilities desired were necessary to promote a project consistent with the economic objectives of the Government. 1/

At the end of 1946, the British Treasury made a direct appeal to the London clearing banks not to finance additional hire-purchase trade, with particular care to be exercised on loans to finance the purchase of consumer goods. This request was reaffirmed in general terms on several subsequent occasions when new directives were released by the British Treasury to the Capital Issues Committee establishing selective criteria for guidance of commercial banks in their lending operations. In April of 1951, Chancellor Gaitskell requested the banks "to ensure that advances are not made for the increased finance of hire-purchase, particularly of consumer goods". Later that year, on December 7, following the restoration of an effective monetary policy, Chancellor Butler sent a new request to the banks that "finance for hire-purchase should be limited"; this request was interpreted to mean that not only should consumer goods financing be restricted but that all types of hire-purchase financing was to be curtailed. 2/

Administration of the control of bank lending for hire-purchase financing has been left in the hands of the commercial banks themselves for loans up to £50,000; for borrowings in excess of that figure in any twelve months, approval of the Capital Issues Committee was necessary. For a credit financing firm to raise new capital, stringent essentiality tests had to be met; however, it is reported that small private finance companies have been organised continuously with capital below £50,000, thereby evading official survellience.

Control over direct commercial bank lending to installment credit firms has not been rigorous. Only in the case of loans known to be for hire-purchase operations could the banks be certain that credit was being curtailed; indirect financing of such trade was difficult to detect. Because of this difficulty, The Economist noted that:

> "No matter how conscientiously the banks screen their loans, funds are bound to find their way into hire-purchase business indirectly if there is a demand for such facilities, and if bank loans are not tightly controlled as a whole." 3/

1/ Capital Issues Control, Cmd. 6645, 31 May 1945. The directive also stipulated that the application must not be "inconsistent with the policy of the Board of Trade from time to time in regard to the conduct of hire-purchase business."
2/ Financial Times, January 14, 1952, page 4.
3/ The Economist, December 29, 1951, page 1592.

The large volume of hire-purchase trade financed by nationalised industries which have drawn upon the money market and the commercial banks for resources has represented an additional loophole in the control machinery.

At the end of January 1952, the British authorities supplemented the more general credit restrictions by introducing an order, along the lines of our own Regulation W, regulating hire-purchase terms on certain durable products as part of a program to divert Britain's metal-using capacity to expanding exports and defense output. 1/ Minimum down-payments of 33-1/3 per cent and maximum terms of 18 months were placed upon the following groups of manufactured products, several of which had not previously been subjected to the regulations:

- radios
- household durables
- beauty parlor equipment
- lawn equipment
- office furniture
- office equipment
- mechanically propelled bicycles and related vehicles

For bicycles and other small vehicles, a 25-per cent down payment and a 12-month term was established. Automobiles require a 33-1/3 per cent down payment with 30 months to pay.

Concluding comments

The curtailment of installment credit in Britain has been part of the Government's program to reduce home demand for durable goods in the interest of expanding export earnings. Although installment credit has not become as important in Britain as in the United States or Canada, its postwar expansion has induced the Government to give it special attention so as to supplement the physical controls exercised through tight allocation schemes. The hire-purchase restrictions were made the subject of Parliamentary debate on three occasions before they had been in effect six months; they have been defended in Parliament as a method which could, in the case of scarce materials, "not only supplement physical controls but can sometimes supersede them and prove equally effective for their purpose, with far less interference with liberty and with consumers' choice." 2/

1/ Hansard, 29 January 1952, column 59. Two companion measures were: open discrimination in the allocation of steel and other scarce materials in favor of export industries and, in exceptional cases, prohibiting the supply to be sold on the home market beyond a certain level.

2/ Hansard, 3 July 1952, column 766.

While the lack of comprehensive statistics make measurement impossible, there is evidence that installment credit has actually been curtailed.1/ In the case of radios, for instance, in January of this year the Government reduced the number of sets that could be sold to domestic consumers by one-third; during the first four months of 1952 cash sales fell by only 24 per cent while hire-purchase sales declined by 59 per cent. In the case of television sets, cash sales fell by 61 per cent and hire-purchase sales by 78 per cent. 2/ In contrast, exports of radio sets in the first five months of 1952 were 15 per cent higher than in 1951 and twice as large as in 1950. The effectiveness of the restrictions on installment credit was enhanced by two factors: first, the restoration of an effective monetary policy in November 1951, and second, the general decline in consumers' demand in reaction to the post-Korean wave of heavy consumers' purchases.

A general tightening of credit provided the appropriate background for special measures to curtail installment lending. For the first time since the end of the war, the monetary authorities have been able in recent months to curtail lending to private industry for all purposes. According to the estimates of the British Bankers Association, total loans of the London clearing banks in August 1952 were nearly 6 per cent lower than in August 1951; lending to the retail trade had declined nearly 18 per cent.

Similarly, total consumer expenditures - measured at 1948 prices in order to show changes in real consumption - declined by 4 per cent between the fiscal years 1950-51 and 1951-52; consumer expenditures on household goods fell by 17 per cent during the same period. The downward trend in consumer expenditures has certainly made it easier for the Government to carry out its program of curtailing installment credit, especially for durable consumers' goods.

1/ The Financial Times reported on May 15, 1952 that, as a result of a special request from the Treasury that banks cut their loans and advances to hire-purchase houses, the total of such loans will be reduced by at least 10 per cent before the end of 1952. (p. 1).

2/ Financial Times, June 14, 1952, p. 1.

October 28, 1952

MONETARY CONDITIONS AND POLICY IN COLOMBIA

Lawrence Bostow

The monetary history of Colombia during the post-war years can be divided into two distinct periods. The first period, which ended in September 1950, was characterized by inflation and the absence of any apparent effort on the part of the Central Bank to achieve conditions of monetary stability. The second period, dating from September 1950, has been characterized by positive actions of monetary control that resulted in a contraction of the money supply between September 1950 and April 1951, a high rate of expansion during the balance of 1951, and a slower rate of expansion during the first part of 1952. The second period has also been characterized by stability of the cost of living index for Bogota, which is the best available index of prices for Colombia.

Special interest in monetary conditions and policy in Colombia is an outgrowth of two events that occurred in 1950 to make September of that year a significant dividing line between these two periods. One of these events was the completion of the Currie Mission report which provided the basis for planning a general economic development program. The other was the completion of a Federal Reserve Board mission survey which outlined a suggested program of monetary reform. The organization of the Colombian Committee for Economic Development in September 1950 was a direct outgrowth of the Currie Mission Report and the fact that this Committee was prepared promptly to urge a program of monetary reform was in part an outgrowth of the Federal Reserve Board mission report.

The appointment of the Colombian Committee for Economic Development in September 1950 turned out to be a significant event affecting Colombia's post-war monetary experience for several reasons. First, it was through the initiative of this Committee that stop-gap measures were taken to stop Colombia's inflation in the fall of 1950. Second, the measures urged by this Committee were designed to stop expansion in the total money supply, rather than, for example, to channel credit into "productive" uses. Third, this Committee was instrumental in urging the Government to broaden the responsibilities and powers of the Central Bank in a manner which would enable it to pursue effectively a policy of monetary stability.

The concern of the Colombian Committee for Economic Development with the need for controlling the total volume of credit and the money supply was an unusual development when contrasted with the limited objective which has been accepted as appropriate for monetary policy in the economic development programs of most of the Latin American countries. This objective has usually been that of channeling credit into "productive" uses. The showing of little concern on the part of development authorities with controlling the total volume of credit in other countries that have experienced pronounced inflation is due largely to one or more of the following factors: (1) a feeling that inflation is inevitable or at least that it is a necessary corollary to economic development; (2) acceptance of a doctrine that "productive" loans are non-inflationary, or even anti-inflationary; and

(3) a practice of crediting inflation to what is usually a manifestation of inflation - the "wage-price spiral", and to what is generally a result of inflation - an increase in "speculative" credit.

Approximately two years have elapsed since the first steps at monetary stabilization were taken in Colombia at the initiative of the Committee for Economic Development. During this time, there has been a remarkable stability in the index of the cost of living for the capital city of Bogota. Whether this means that desired conditions of long-term monetary stability have been achieved is, however, open to question on several grounds.

First, the cost of living index for Bogota is heavily weighted by commodities whose prices are affected strongly by local weather and crop conditions; this means that movements of the index do not necessarily reflect either the direction or the magnitude of change in the real value of the Colombian peso during any given short period.

Second, effective measures of credit restraint that were imposed in September 1950 were gradually replaced beginning early in 1951 by measures designed to expand the money supply. This program of expansion resulted in an 18 per cent increase in Colombia's money supply during the last half of 1951, and the money supply expanded by an additional 13 per cent during the first eight months of 1952.

It would seem that a renewal of monetary expansion in 1951 at this high rate could be justified only if it had been motivated by knowledge of a serious downward trend in employment and output. Relevant statistical indicators of economic activity are, howerer, almost totally absent in a form which would have been useful to Colombia's monetary authorities during this period. On the other hand, it seems certain that transitional symptoms of a business recession must have appeared in Colombia following the sudden halt to credit expansion that occurred in September 1950. If monetary expansion was resumed for the purpose of eliminating these symptoms, the result may well have been to restore a level of business activity and a pattern of resource utilization whose maintenance would require continued inflation.

While these considerations suggest that evidence does not exist for concluding that monetary stability has been achieved in Colombia, they also suggest some of the problems involved in attaining a monetary policy objective which, primarily because of the absence of adequate statistics, is not always recognizable when achieved.

This paper attempts to analyze some aspects of Colombia's monetary policy during the last two years against the background of the country's monetary experience during the entire post-war period. The first part describes monetary conditions in Colombia since the end of World War II, with particular emphasis on the role of the Central Bank in the inflation prior to September 1950, and on the effectiveness of positive measures that have been taken to regulate Colombia's money supply since that time. The second part deals with the policies and the framework for the formulation of monetary policies that contributed to these conditions. Some of the deficiencies noted in this framework, such as the absence of adequate statistical indicators of economic activity for the guidance of monetary authorities, are not, of course, unique to Colombia. Rather, they are illustrative of the obstacles to achieving conditions of monetary stability in a country such as Colombia even if there exists a sincere desire to do so.

Monetary Conditions since 1945

Conditions prior to September 1950 - Colombia ended the year 1945 with foreign exchange reserves amounting to \$177 million (approximately \$150 million of which had been accumulated during the war), with a domestic money supply more than two and a half times greater than in 1941, and with prices about 70 per cent higher than they were in the years immediately preceding World War II. By September 1950, foreign exchange reserves had declined to \$123 million 1/, the money supply had increased by an additional 124 per cent, and prices had approximately doubled from their level at the end of 1945. Cumbersome and inefficient direct controls characterized the Colombian economy, and an increasing share of investible resources were flowing into activities that added little to the country's productive capacity.

The major factors that accounted for monetary expansion in Colombia during this period are summarized in Table I. It may be noted that changes in each of the factors listed in this table tended to increase Colombia's money supply in one or more of the post-war years. The one factor which operated consistently in this direction from the end of 1945 through 1950, however, was an expansion of central bank credit to commercial banks and other private entities.

Inflationary financing of government expenditures 2/ was an important factor tending to increase Colombia's money supply from 1946 through 1949, and it may be assumed that this was something over which the Central Bank had little effective control. In each of these years except 1946, however, additions to Colombia's money supply resulting from increases in central bank credit to non-governmental entities exceeded that which resulted from inflationary fiscal operations of the Government.

In 1947, the combined effect of government deficit spending and central bank credit expansion to non-governmental entities was sufficient to cause an expansion of 10 per cent in Colombia's money supply in spite of the loss of 92 million pesos in foreign exchange reserves by the Central Bank. The same factors operated to increase Colombia's money supply by an additional 17 per cent in 1948 when the foreign assets of the Central Bank were reduced by 31 million pesos.

1/ Including Colombia's subscription of \$12.5 million to the International Monetary Fund.

2/ Including expenditures of official entities.

TABLE I

Major Factors Affecting Colombia's Money Supply 1/
and Yearly Percentage Increase in Money Supply and Prices, 1946-1951
(Amounts in millions of pesos)

	1946	1947	1948	1949	1950	1951
Major Factors Affecting Money Supply 1/						
1. Change in Selected Assets of Central Bank						
(a) Foreign assets	-1	-92 2/	-31	+53	-20	+43
(b) Credits to government and official entities	+22	+45	+33	+16	-38	+16
(c) Credits to commercial banks and other private entities	+9	+75	+56	+31	+73	-3
2. Change in Government Deposits with Central Bank (Decrease +, Increase -)	+13	+26	+12	+5	-13	-58
3. Other 3/	-	-	-	-	-	+51
Total of foregoing factors	+43	+54	+70	+105	+2	+49
Per Cent Increase in Money Supply	23%	10%	17%	22%	5%	16%
Per Cent Increase in Prices (Cost of living in Bogota)	17%	13%	15%	4%	28%	-4%

Source: International Monetary Fund, International Financial Statistics and Revista del Banco de la Republica

1/ The factors listed affect the money supply either directly or through their effect on commercial bank reserves. In addition, there were significant changes during the period in the extent to which commercial banks used available reserves to expand their loans, as against their holdings of excess reserves. A decline in the banks' ratio of excess to total reserves was an additional expansionary factor in 1946, 1949 and 1950.

2/ Not including Colombia's gold payment on its IMF subscription.

3/ Of the 51 million peso figure shown for 1951, 15 million pesos represents the return to circulation of pesos which had been held by the stabilization fund as import guarantee deposits, and 36 million represents funds deposited in commercial banks by the central bank for the purpose of increasing loanable reserves.

In 1949, inflation-induced controls over imports succeeded in producing a surplus in Colombia's balance of payments, and the resulting purchases of foreign exchange by the Central Bank became an added factor tending to increase the money supply. In addition, commercial banks, whose ratio of excess to total reserves had been 29 per cent at the end of 1947 and 1948, reduced this ratio to less than 21 per cent by the end of 1949. The Government also contributed to continued inflation by increasing its loans and reducing its deposits with the Central Bank, although at a slower rate than before. With all of these factors tending to increase Colombia's money supply during 1949, the Central Bank might have been expected to take some compensatory action. However, it continued expanding its credit to private entities as well as to the Government, and Colombia's money supply expanded by 22 per cent in 1949.

The 16 per cent increase in Colombia's money supply that occurred during the first nine months of 1950 (not shown separately in Table I) was largely the result of commercial bank utilization of excess reserves. The reduction in the ratio of excess to total reserves by commercial banks during both 1949 and 1950, however, may be attributed largely to previous policies which had taught commercial bankers that there was little risk in being "loaned up". Loans that would have appeared risky under normal conditions now seemed quite safe because of continued inflation, and experience indicated that funds would be available at the Central Bank if needed. The Central Bank contributed both to the optimism of commercial bankers and to their ability to expand loans during the first nine months of 1950 by extending them additional credit amounting to 10 million pesos.

Credit restraint by "Gentlemen's Agreement", September 1950 - March 1951 - By the second half of 1950, the economic structure of Colombia was warped by inflation to a point where positive action was called for, and the Colombian Committee for Economic Development gave first priority to the solution of this problem at the time of its appointment in September. In line with its recommendations, all commercial banks by "gentlemen's agreement" undertook to limit their future lending operations to the level of loans outstanding on September 30, 1950 and the Government expressed its determination to stop deficit financing. The results of this policy through March 1951 are shown in the following table:

TABLE II

Colombia: Money Supply, Credit and Prices, Sept. 1950-March 1951
(Amounts in millions of pesos)

	1950				1951		
	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.
Domestic Credits of Commercial Banks	767	742	735	722	717	720	724
Government Loans from Banco de la Republica	136	140	133	132	132	131	136
Money Supply	1,060	1,005	998	962	955	945	927
Index of Prices (Cost of living in Bogota, 1948=100)	135	140	140	141	140	139	140

Source: International Monetary Fund, International Financial Statistics

As indicated above, the measures that were put into effect in September 1950 brought Colombia's monetary expansion to an abrupt halt, and actually resulted in a decline in the money supply during the following six months. By November the rise in the cost of living in Bogota was also halted.

Money supply under planned control, 1951-June 1952 - The "gentlemen's agreement" for voluntary credit restraint was superseded in May 1951 by a quota restriction on commercial bank loans and discounts from the Central Bank; to this extent, the form of a credit restraint program was maintained in 1951. However, several important measures were taken by the Government and the Central Bank during that year to renew expansion of the money supply. The most significant actions were the following:

(1) In February commercial bank reserve requirements for demand deposits were reduced from 15 to 12 per cent;

(2) In April the Central Bank added 20.6 million pesos to the reserves of commercial banks by redepositing government funds in these banks; 1/

(3) In August approximately 15 million pesos that had accumulated with the stabilization fund as import guarantee deposits were released;

1/ The Colombian Government apparently does not hold deposits in commercial banks for its own account.

(4) In December the central bank's deposits of government funds with commercial banks was increased from 20.6 million pesos to 36 million pesos.

In addition, there were increases in the central bank's foreign assets and in its credits to the Government, as shown in Table I.

During January 1952, the Central Bank again embarked on a program of credit restriction by taking three actions. First, it announced an increase from 12 to 15 per cent in the commercial bank reserve requirement for demand deposits, with the increase to be spread over six months at the rate of one-half per cent per month. Second, it imposed a supplementary reserve requirement against increases in deposits by providing that all deposits in commercial banks above the level of January 11, 1952 would be subject to a reserve requirement of 40 per cent. Third, the Central Bank began a gradual withdrawal of government funds from commercial banks. By the end of July (latest date for which data are available), only 3.3 million pesos of government funds remained on deposit with commercial banks.

As indicated in the following table, Colombia's monetary expansion in 1951 resulted in an increase in money supply by 18 per cent from 950 to 1,119 million pesos during the last half of the year. The program of credit restraint adopted in January of this year also appears to have been at least partially successful in that monetary expansion was reduced to 5 per cent for the first six months of 1952. This has been followed, however, by an increase of 8 per cent during the two months of July and August.

TABLE III

Colombia: Money Supply, Credit and Prices, June 1951-August 1952
(Amounts in millions of pesos)

	1951			1952		
	June	Sept.	Dec.	Mar.	June	Aug.
Domestic Credits of Commercial Banks	750	791	837	852	847	879 1/
Government Loans from Banco de la Republica	136	141	151	155	162	161
Money Supply	950	1,002	1,119	1,146	1,176	1,267
Index of Prices (Cost of living in Bogota, 1948=100)	145	138	136	136	141	135

Source: International Monetary Fund, International Financial Statistics

1/ End of July

It may be noted from the preceding table that the cost of living index for Bogota has moved in the opposite direction from what might have been expected in view of the rapid increase in Colombia's money supply. However, reports from Colombia have indicated that agricultural production in 1951 exceeded considerably the output of the two preceding years. Whether this is a suffucient explanation for the seemingly perverse movement of the index cannot be determined from available statistical data. The fact that a change in short-run supply conditions could cause such a movement, however, serves to illustrate the deficiency of this particular index both as a guide to monetary action and as a criterion for evaluating policy during any given short period. A broader basis for evaluating past policies and the prospects for future monetary stability in Colombia should therefore rest in part on an assessment of the institutional framework for the formulation of monetary policy, and on the objectives and guides that prompted the renewal of rapid monetary expansion during 1951. These factors are discussed in the following section.

Framework of Colombia's Post-War Monetary Policy

The institutional framework - Prior to September 1950, the division of responsibility for monetary management in Colombia was so great that a monetary policy did not exist which was worthy of the name. The Banco de la Republica, nominally a central bank, was a semi-private[1/] institution whose policies were conditioned partly by profit considerations and partly by the passive observance of fixed rules which could be appropriate only if all of the rules of the "gold standard game" were observed. Not all of these rules were observed, however, since restrictions on trade and international payments protected the reserves of the Banco de la Republica, thereby permitting it to expand credit without any real limit as long as eligible paper was presented for discount.

Under the circumstances, it is hardly surprising that in 1950 the Banco de la Republica lacked an effective research staff which could provide the bank directors with statistical indicators and economic analysis of the type that would normally be considered most relevant for decisions involving monetary policy and action. Such indicators were simply not considered useful in view of the rules which were defined by statute for the Banco de la Republica and in view of the Bank's incentives to maximize its earnings given the restraints provided by those rules.

Because of defects such as those mentioned above, the Committee for Economic Development assumed a leading role in pressing for a program of reform during the first few months after it was organized in September 1950, and its recommendations are partly reflected in Decree No. 756 of April 5, 1951. This decree provided that "the Banco de la Republica will

1/ As of 1951, private interests owned 57.4 per cent of the capital stock of the Bank, and 42.6 per cent was owned by the Government. Only three out of the nine members of the Board of Directors are appointed by the Government.

carry out a monetary, credit and exchange policy aimed at stimulating conditions propitious to the ordered development of the Colombian economy" and stipulated that an expanded research department should be established within the Bank. It also provided the Bank with powers and discretionary authority to control the money supply, although certain policy decisions were made subject to veto by the Minister of Finance.

In view of these changes and the general awareness of the dangers of inflation and of the measures that can be taken to prevent inflation, Colombia's experience during the early post-war period is not likely to be repeated in the near future. Decree No. 756, however, did not modify the existing status of ownership and control over the Banco de la Republica, and it did not specify that the Bank would have full responsibility for monetary management. In effect, therefore, the Bank was provided with more of the means for achieving conditions of monetary stability, but institutional changes were not made that would reduce the Bank's incentives to follow policies which had previously led to inflation.

The fact that a profit motive still exists in the operations of the Banco de la Republica suggests that restrictive credit policies might not be adopted in the future which would lead to financial loss for the Bank even if such action seemed necessary to prevent inflation. The presence of a profit motive does not appear to be the explanation for rapid monetary expansion during 1951, however, since the actions which were taken to increase Colombia's money supply in that year could not have been designed to increase the earnings of the Central Bank.

The more serious defect for the present is that a majority of the Board of Directors of the Banco de la Republica are still selected by private interests that are likely to benefit by credit expansion and that tend to regard the limitation of financial resources, rather than the limitation of real resources, as being the factor which limits the volume of productive investment. The probability of a resulting bias to monetary management is indicated by the fact that officials of the Banco de la Republica were seriously concerned in 1950 with businessmen's complaints concerning the "scarcity of credit" and the adverse impact that this was having on their investment plans. This was at a time when commercial bank credit had been expanding for several months at an incredible rate of 40 per cent per year.

<u>Motivations for monetary action</u> - Since April 1951, as noted above, the general objective for monetary policy assigned to the Banco de la Republica has been that of "stimulating conditions propitious to the orderly economic development of the Colombian economy". This is the kind of objective which could be assigned to all governmental and semi-governmental agencies, however, and leaves the selection of proximate objectives to the Bank. An objective of the type that would be normally attainable through controlling the total volume of credit and the money supply, however, has not been explicitly defined. The problem, therefore, is to see whether actions taken by the Colombian monetary authorities in 1951 were based on a set of objectives and guides which could be expected to lead to conditions

of monetary stability. A part of the answer can be obtained by outlining a possible set of objectives and guides, and asking whether the motivations for monetary action in Colombia could have been provided by such a set.

A possible objective which seems consistent with the usual interpretation of monetary stability (if it is assumed that price stability and full employment are not incompatible goals) could be the following: to control money demand in such a way as to provide for (a) an increase in money incomes at a rate not lower than the rate of increase in real incomes under conditions of a long-term balance in international accounts, and (b) an increase in money incomes at a rate in excess of the rate of increase in real income only if this should become necessary to prevent unemployment.1/

Assuming that actions by Colombia's monetary authorities in 1951 had been motivated by this objective (or some other which might be stated in part, for example, in terms of some constant rate of change in the real value of money), a number of guides to monetary policy would have been useful. Among the most important would have been current statistics on employment, money income and prices, estimates of the prospective rate of growth in real incomes under conditions of a balance in international accounts, and estimates of prospective changes in the rate of turnover of money.

To the extent that these guides take the form of statistical indicators, however, they seem to be practically non-existent in Colombia in a form which could be useful to monetary authorities. National income statistics are apparently not maintained on a current basis; indices of employment are apparently not compiled, and the use of existing fragmentary statistics on output and prices could lead to serious errors in monetary management.

The meagerness of statistical indicators of prices and economic activity in Colombia precludes a reasonable appraisal of the effects of recent monetary actions, but of greater significance is the fact that such indicators have apparently not been available to the framers of Colombia's monetary policy. It does not seem likely, moreover, that the renewal of monetary expansion in 1951 could have been prompted by expected changes in real income and the rate of turnover of money. The remaining guides to monetary action which could have been used appear to be of the type that were provided by Colombia's businessmen during this period. By this is meant the reported complaints that inventories were not "moving", that business had become "sluggish", that credit was "too tight", etc.

To the extent that complaints of the type mentioned above may have created fears of impending unemployment, Colombia's monetary expansion during 1951 need not have been inconsistent with the objective which

1/ There is no certainty, of course, that this objective would lead to monetary stability, however defined. This would depend in part on a definition of full employment and in part on whether there is in fact a tendency toward full employment under conditions of price stability. However, this statement seems to provide a suitable frame of reference to which the actions of the Colombia's monetary authorities in 1951 can be related.

was outlined above. It should be noted, however, that the sudden halt to credit expansion during the fall of 1950 had been designed largely to re-channel resources from occupations that had been made remunerative because of inflation and into occupations that would be remunerative under conditions of monetary stability. In this process, the profitability of many activities was to be purposely reduced or eliminated, and the most vociferous type of complaints could have been expected from businessmen who had become accustomed to making their investment plans on the basis of expectations of continued credit expansion and inflation. The fact that complaints of this type actually did result might have been regarded, therefore, as a healthy sign of the effectiveness of stabilization measures that had been taken, rather than as an indication of the need for renewing a rapid expansion of credit.

There is no way of accurately noting employment trends from the type of data available for Colombia. Such data as are available, however, do not support a view that there was substantial unemployment in Colombia during 1951.[1] On the other hand, the fact that world demand for Colombia's export goods was rising suggests that the extent of possible unemployment due to credit restrictions should have been at a minimum during this period. Moreover, the fact that complaints concerning the "tightness of credit" continued suggests that a wide range of investment possibilities must have existed in Colombia that were considered profitable even under conditions that indicated a possibility of some deflation.

In the light of these considerations, and since monetary expansion was renewed only about six months after the "gentlemen's agreement" for credit restraint was inaugurated in September 1950, the rapid expansion of Colombia's money supply in 1951 may have prevented the full development of a pattern of resource utilization which would be optimal under conditions of long-term monetary stability. If this has been the case, at least some degree of inflation may have to be continued in order to avoid symptoms of a business recession comparable to the ones which apparently motivated Colombia's program of monetary expansion in 1951.

1/ See Table IV. It may be noted that there was a marked decline in the budgeted value of building construction after the third quarter of 1950. This decline may reflect some reductions in construction costs, and may also be due in part to a bias in the basic data from which the index is derived. The index may be affected directly, for example, by changes in the volume of mortgage loans made by the banking system. The high volume of investment in "luxury" construction during 1950, however, was one of the principal concerns of the Colombian Committee for Economic Development, and the actions that it recommended were designed in part to reduce this type of investment.

TABLE IV

Colombia: Indices of Production 1/
Quarterly, 1950-1st quarter 1952
(1949=100)

Period	Budgeted Value of Building Construction	Petroleum (Quantum)	Cement (Quantum)	Electricity (Quantum)
1950 - 1st qtr.	144	101	104	101
2nd qtr.	147	113	106	111
3rd qtr.	175	120	133	121
4th qtr.	113	125	144	119
1951 - 1st qtr.	116	129	136	110
2nd qtr.	86	132	128	121
3rd qtr.	105	132	143	121
4th qtr.	109	125	137	122
1952 - 1st qtr.	105	129	134	113

Source: Revista del Banco de la Republica

1/ Data derived from published monthly indices using a base of 1934=100.

Conclusion

The analysis contained in this paper does not lend itself to a conclusion that conditions of long-term monetary stability have or have not been achieved in Colombia. The very lack of evidence for making such a judgment suggests, however, that monetary expansion during 1951 must have been motivated in part by unreliable evidence concerning the most significant effects, whether "good" or "bad", of measures that had previously been taken to stop Colombia's inflation.

Given that adequate objective indicators of economic activity are not available in Colombia, a tendency toward avoiding the risk of unemployment might be expected to provide an inflationary bias to monetary management. This seems to have been the case during a period for which a certain amount of transitional unemployment could have been predicted at the time when severe credit restrictions were imposed in September 1950.

It has been noted that a program of credit restraint was again adopted in Colombia in January 1952. However, the increase in money supply that has occurred since that date would seem ample to provide for whatever degree of inflation might be necessary to maintain full employment, assuming that resource utilization in Colombia has not adjusted to a pattern that would represent equilibrium under conditions of long-term monetary stability.