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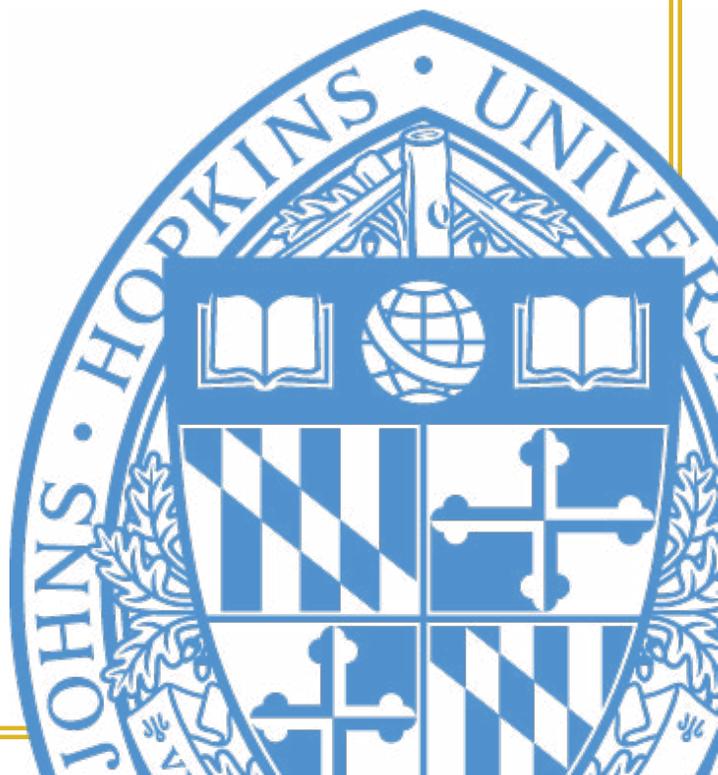
**HISTORY, POLICIES AND
FINANCIAL STATEMENTS OF
THE IRISH CURRENCY
COMMISSION AND THE
CENTRAL BANK OF IRELAND
(1927-1979)**

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Global Health, and Study of Business Enterprise



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History, Policies and Financial Statements of the Irish Currency Commission and the Central Bank of Ireland (1927 – 1979)

By Charlie Wang

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About the Series

The Studies in Applied Economics series is under the general direction of Professor Steve H. Hanke, co-director of the Johns Hopkins Institute for Applied Economics, Global Health, and the Study of Business Enterprise (hanke@jhu.edu). This working paper is one in a series on currency boards. The currency board working papers will fill gaps in the history, statistics, and scholarship of the subject. The authors are mainly students at The Johns Hopkins University.

About the Author

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Abstract

When Ireland gained its independence from the United Kingdom in 1922, contrary to the recommendations offered by the League of Nations, the new country established a Currency Commission that operated similar to a currency board rather than a central bank. I analyze the structure of the Currency Commission and describe the establishment of a central bank in the 1940s with limited monetary powers, then later a central bank with broader powers. I compare the legal structures and operations of the early Central Bank of Ireland and the Currency Commission balance sheet analysis and other approaches to conclude that there are distinct differences between a currency board and a central bank that operates like one.

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Keywords: Ireland, central bank, currency board, balance sheet

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I. Introduction

Although the country referred to as Ireland today has a history that stretches back for centuries, the part of history that is of interest to the discussion of this paper can be traced back to when Ireland first joined with Great Britain in 1801 following the passing of the Acts of Union 1800, which brought both kingdoms – the Kingdom of Great Britain and the Kingdom of Ireland – together into the United Kingdom of Great Britain and Ireland. Ireland was a part of the union until 1922 when the Irish Free State (in Gaelic, Saorstát Éireann) broke from the union and established itself as a self-governing dominion following the Anglo-Irish Treaty of December 1921.

When the constitution of the Irish Free State came into operation on December 6, 1922, the only full legal-tender paper currency that was in circulation in 1922 was the notes issued by the British government (Moynihan 1960: 20). Those notes, nicknamed Bradburies after the official whose signature appeared on them, were issued as a World War I emergency measure in amounts from 2 shillings 6 pence (£0.125) to £1.¹ Also in circulation, an accepted means of payment were notes issued by the Bank of England and by several Irish commercial banks. The financial markets and banks of Ireland were closely tied to those of England when Ireland was part of the United Kingdom, and thus, all the provinces of Ireland used the pound sterling as the official currency. Even today, Northern Ireland, which remained a part of the United Kingdom after the Irish Free State became independent, continues to use the pound sterling and have arrangements such as note issues by commercial banks (Dixon 2015: 14-21), continuing currency arrangements that are reminiscent of those before and during the early years of the Irish Free State.

II. The Influences and Establishment of the Currency Commission

Following the successes of becoming a self-governing dominion in 1922, the idea of establishing the State's own currency was a logical and natural progression, as it would give the Irish Free State control over the supply and issuance of coinage and would help provide the Irish Exchequer, the national treasury, a profit (Moynihan 1960: 24). There were multiple considerations related to how to set up the new currency and the financial system of the Irish Free State. Due to the details that needed to be worked out, the Minister of Finance notified the existing banks in April 1925 that he would be setting up a body to consider changes to banking and note issue laws (Moynihan 1960: 38). The body came to be known as the Currency Commission. By February of 1926, the members of the Commission were announced, and the formal warrant of appointment was signed by the following month (Moynihan 1960: 39). The chairman of the commission was Henry Parker Willis, an American economics professor who had been director of research for the Federal Reserve Board of Governors and president of the Philippine National Bank, a note-issuing commercial bank. The Philippine government of the era also issued notes, under a currency board-like arrangement.

¹ Under the currency system used in Britain and Ireland until decimalization occurred in 1971, £1 = 20 shillings (s.) = 240 pence (d.).

The question of setting up a new currency independent of the pound sterling arose. Historically, from the late 1700s, Ireland had a note issue separate from those of England, Wales, and Scotland – several local banks issued notes, though the privately-owned Bank of Ireland had certain privileges beyond those accorded to the other banks. Also, the old Irish pound had been a separate unit of account from the pound sterling until the 1820s. Should the new currency be linked to the pound sterling or not? The underlying factor that influenced the decisions the Commission made was the country's close ties to Great Britain. At the time of separation, Britain was Ireland's largest import and export partner (Moynihan 1960: 67). Thus, for the foreseeable future, the Commission considered that because trade would be tied to Britain, and without strong institutions independent of British finances and credit policies (Moynihan 1960: 67), any monetary policies set forward in Britain would greatly influence and possibly override whatever policies were set forth in Ireland.

Thus, to maintain the existing level of nominal prices and freedom of trade between Ireland and Britain (Moynihan 1960: 66), the Commission decided that there should be parity between the Irish currency, which would come to be known as the Irish pound (or punt, in Gaelic), to the pound sterling. Similarly, the opinion of the general business community, as represented by the Associated Chambers of Commerce, was that the Irish pound should be at parity with sterling (Moynihan 1960: 65). With parity, the public would maintain its confidence in the currency. Nonetheless, fixing the Irish pound to sterling would place Ireland entirely in the hands of whatever monetary policy arose in Britain (Moynihan 1960: 22). For example, the deflationary policy followed by Britain in the early 1920s so that it could return to the pre-World War I exchange rate of sterling with gold had been considered disastrous for Ireland (Moynihan 1960: 75). The Commission recognized that farmers who had bought land at high prices during the expansionary period right after World War I had seen their wealth diminished due to falling prices (Moynihan 1960: 65). However, the Commission emphasized that by establishing parity, the Irish pound would have unquestioned value since the currency had no gold reserves of its own (Moynihan 1960: 66). Thus, parity between sterling and the Irish pound would be maintained.

Another major question the Currency Commission faced was whether to establish a central bank. On the international stage, the consensus of opinion was that any country without a central bank should establish one, per the proceedings from the League of Nations International Financial Conference, 1920 (9). On the other hand, the Commission argued against a central bank, contending that the Irish Free State lacked the fundamental elements needed for an effective central bank, notably a local capital market and a short-term money market (Moynihan 1960: 67). Without these two fundamental elements that showed evidence of substantial liquidity of both private and public Irish credit, a central bank would not be able to operate effectively. Furthermore, the Commission argued that though they could solve the problems identified, such as by creating a short-term money market, the support to central bank policies that naturally comes with a well-defined and established market would be lacking in a new capital market (Moynihan 1960: 67).

The primary concern that the Commission needed to address was issuing notes, and the Commission believed that the goal could be achieved at a greater pace and with less cost without having to set up a central bank (Moynihan 1960: 51). Likewise, though there was a need for money markets, there was still access to money market facilities through offices in London. The country as a whole had a sound banking system, and the banking business of the government was satisfactory (Moynihan 1960: 50), so if it was working, there was no need to change it.

The Minister of Finance agreed with the proposal set forth by the Currency Commission to proceed as a Banking Commission and not as a central bank. The Minister added that though keeping many elements of the existing banking system was conservative, the existing system did have the confidence of the public (Moynihan 1960: 73). In fact, the argument was that any disturbance of the existing system to set up a central bank would likely cause more damage than was worth facing (Moynihan 1960: 73). Furthermore, with the decision of pegging the Irish pound to sterling, according to the Commission, a slightly fluctuating rate of exchange between Ireland and Britain would most likely develop (Moynihan 1960: 67), which was exactly the opposite of the Commission's decision with regards to the exchange rate.

These ideas were rolled up, along with some others, into the Currency Act, 1927. The Act bestowed one power on the Currency Commission – the power to exercise the functions of a banker (Currency Act, 1927, Section 63, Subsection 3). Furthermore, in the Act, eight banks – the Bank of Ireland, the Hibernian Bank Limited, the National Bank Limited, the Northern Bank Company Limited, the Munster and Leinster Bank Limited, the Provincial Bank of Ireland Limited, the Royal Bank of Ireland Limited, and the Ulster Bank Limited – became the Shareholding Banks of the Currency Commission (Moynihan 1960: 97). Of the six commissioners, three were selected by the banks, while the other three were elected by the Minister of Finance. These six then elected the chairman – the first chairman being Joseph Brennan, formerly the top civil servant in the Department of Finance (Government of Ireland, *Currency Act, 1927*, section 18). And thus, this group of seven was formally established as the first official Currency Commission as of September 21, 1927 (Moynihan 1960: 110).

In the following years, the first Currency Commission was occupied with the bank notes that individual banks had that were circulating in the country, issuance of new consolidated bank notes, issuance of new token coins according to the Coinage Act, 1926, and counterfeiting. The Currency Act, 1927 gave the Currency Commission power to combine the multiple bank note issues into a consolidated issue, and reduce and eventually eliminate the bank note issues. Banks received some compensation for the loss of their note issues.

III. The Second Commission of Inquiry in the Currency and the Transition to a Central Bank

As the 1930s came around, sentiment for establishing more central banks was once again in the air. The British Empire saw the establishment of the Reserve Bank of New Zealand in 1934, the Reserve Bank of India in 1935, and the Bank of Canada in 1935 (Moynihan 1960: 202). On November 20, 1934, the Minister for Finance appointed a second commission of inquiry to

examine and report on the financial system in Ireland, especially with regards to banking, credit, currency, and lending (Moynihan 1960: 204). Though not explicitly stated and though the business community and public at large did not hold the idea in much regard (Moynihan 1960: 207), the second currency commission was also established for evaluating the possibility of a central bank.

The second commission was composed of 20 people, including a “bishop, university professors, trade union officials, businessmen, and civil servants” (Moynihan 1960: 204). Of the 20, a chairman of the Agricultural Credit Corporation and a chairman of the Industrial Credit Company Limited represented the interests of the Irish rural community. Moreover, the Shareholding Banks had a presence, with three members. The commission presented its report to the government in 1934.

In Chapter VII of the majority report, the second commission of inquiry recognized that the Irish monetary system had worked satisfactorily since the passing of the Currency Act, 1927 due to two factors: the link with sterling and the large external reserves accumulated (Moynihan 1960: 208). Overall, interest rates in the country were reasonable, which could be attributed to the well-established connection between the Irish banking system and the British banking system. Furthermore, although Ireland did not have a central bank and thus the Currency Commission had no power to supply funds against domestic assets, there was no difficulty for Irish banks since they had large holdings in sterling (Moynihan 1960: 211).

Nonetheless, though the monetary system seemed fine, factors from the world stage influenced the establishment of an Irish central bank. At the World Economic Conference of 1933, there was an emphasis on having central banks independent of governments and political affairs for economic progress and development. Additionally, as World War II approached in 1939, there was a realization among the government that a gap existed in the financial mechanism of the State, specifically with regard to control over external payments and the purchase and sale of foreign securities, which were all limited under the existing powers of the Currency Commission (Moynihan 1960: 287). In fact, most of the power was in the hands of the banks in Ireland, and these same banks were only loosely associated in a non-statutory committee whose meetings were infrequent.

The Irish government also wanted the existing banks in the Irish monetary system to increase their domestic assets and to expand the credit available locally. Thus, the central bank would serve as an influencer of the commercial banks. The second commission of inquiry was cautious, especially with regards to having the central bank serve as the lender of last resort (Moynihan 1960: 213). Nonetheless, the government was receptive to the idea of a central bank, and the commission worked on drafting a bill for one.

With the drafting of the bill came the question once again whether to continue the parity between the Irish pound and sterling. The majority report of the second commission of inquiry unequivocally recommended maintaining the parity. With the parity, Ireland, as a member of the

sterling area, could benefit from exchange stability, sound credit conditions, and relatively stable price structures. Furthermore, the parity enjoyed the confidence of the public, safeguarded against fluctuations in the domestic price levels, and allowed Ireland a stable exchange rate with other countries in the sterling area (Moynihan 1960: 218).

The Central Bank Bill was drafted and sent to the government on March 4, 1942 (Moynihan 1960: 281). Though this period included the fall of France in World War II, and the threat of invasion of Ireland and Britain was of utmost prominence, the Dáil (lower house of parliament) hotly debated the Central Bank Bill along with the link to sterling, the degree of independence or subordination of the Central Bank, and the commercial banks' positions in respect to the Central Bank (Moynihan 1960: 302). In total, over 67 amendments were proposed (Moynihan 1960: 303) before the bill made it through the summer of 1942. By the time the bill was passed and accepted on October 29, 1942, it had been revised with compromises between more government control versus safeguarding the interests of commercial banks. In the end, the powers of the Central Bank were enlarged to some extent while the previous legislation regarding the backing of the currency was relaxed (Moynihan 1960: 308).

On November 4, 1942, President Dr. Douglas Hyde signed the bill and the Central Bank Act, 1942 came into operation (Moynihan 1960: 308). The Central Bank Act dissolved the existing 15-year-old Currency Commission, transferred all the power and duties of the Commission to the newly established Central Bank, and furthermore included additional duties and power on the Central Bank.

IV. The Early Central Bank of Ireland (1943-1953)

The newly established Central Bank of Ireland enjoyed more power than the previously established Currency Commission. A key provision of the Central Bank Act, Section 6, said:

In addition and without prejudice to the functions, powers, and duties vested by law in the Commission immediately before the appointed day and to such functions, powers, and duties as are specifically conferred or imposed by this Act on the Bank, the Bank shall have the general function and duty of taking (within the limit of the powers for the time being vested in it by law) such steps as the Board may from time to time deem appropriate and advisable towards safeguarding the integrity of the currency and ensuring that, in what pertains to the control of credit, the constant and predominant aim shall be the welfare of the people as a whole.

Functions that the Central Bank inherited from the Currency Commission included the management of issuance and redemption of legal tender notes as well as curtailing the use of consolidated bank notes that had been created under the Currency Act, 1927. Further inherited and new functions of the Central Bank included:

- Purchase and sale of gold and silver bullions, foreign currencies, and coins

- Acceptance of interest-free deposits from the Ministers of State, public authorities, banks and other credit institutions
- Rediscounting bills and fixing and publicizing the minimum rediscount rate
- Lending of security to both banks and credit institutions
- Dealing (buying, holding, and selling) in quoted State or public authority securities or of securities guaranteed by external governments
- Keeping registers on the State and public authority securities
- Keeping accounts of bankers' clearings

Besides those functions, the Central Bank was tasked with collecting and studying data regarding the country's monetary and credit problems, publishing material with respect to the data and maintaining contact with external monetary authorities (Central Bank Act, 1942, sections 7-8).

Heading the new central bank was Joseph Brennan, who had served as the chairman of the Currency Commission during the Commission's entire existence (Moynihan 1960: 311). A new board was also formally announced for the Central Bank on January 29, 1943, and it came into effect a few days later on February 1, 1943 (Moynihan 1960: 311).

The board consisted of eight directors. Three were banking directors, initially from the Provincial Bank of Ireland, the Bank of Ireland, and the Munster and Leinster Bank. Their terms ranged from two years to five years. Two directors were permanent civil servants, including the Secretary of the Department of Finance. Another was a Galway businessman, another was General Secretary of the Irish Transport and General Works' Union, and the last director was a farmer in County Wexford. These directors, in addition to Governor Brennan, who had a seven-year statutory term, oversaw the Central Bank of Ireland (Moynihan 1960: 311).

In its first few months, the Central Bank experienced little change from the functions and responsibilities inherited from the Currency Commission, especially maintaining parity with sterling. However, within the first year of the Central Bank's existence, one major policy change did occur: the Central Bank announced on November 23, 1943 that it would rediscount Exchequer bills (short-term Irish government securities) and certain other securities at a minimum rate of 2.5 percent (Moynihan 1960: 315).

Over the next few years, especially from 1944-1945, the Central Bank noticed evidence of inflation. The cost-of-living index in Ireland greatly increased in respect to Britain. Furthermore, though there was restraint on the creation of credit by the Central Bank, wages and agricultural prices steadily rose, along with property values and security prices. Likewise, consumer prices were high, though stable, but the outlook for some important agricultural products was unsatisfactory, paired with a deterioration of the external trade balance and a notable increase in bank deposit turnover (velocity of money). After the end of World War II, imported goods greatly increased to replenish the stock that had been depleted during the wartime interruption of trade. Imports were financed by increased bank credit. Heavy taxation, large public expenditure, and expected further expansions in public expenditure compounded the inflation

problem. Over its first five years, the Central Bank of Ireland was regarded as a failure, as it was blamed for not more actively exercising its powers (Moynihan 1960: 323 - 337).

As if the negative outlook of the trade balance was not enough, talk of devaluation of sterling against the U.S. dollar emerged from the British government. Talks commenced once again to break the link between the Irish pound and sterling. It appeared that the question was still not resolved when on September 17, 1949, the Bank of England and British Prime Minister gave advance information to the Irish government of their decision to devalue sterling (Moynihan 1960: 355). The official exchange rate with the United States dollar would be altered from \$4.03 to \$2.80 per pound, a devaluation of 30.5 percent (Moynihan 1960: 355). Since the Irish pound was pegged to sterling, this corresponded to a devaluation of 30.5 percent for the Irish pound.

The Minister of Finance issued a public statement shortly after the British devaluation that the course of least disadvantage for Ireland was to allow the devaluation and preserve the parity with sterling. Alternatives included choosing some intermediate rate that was higher than \$2.80, or keeping the old rate of \$4.03 per Irish pound. The eventual higher cost of dollar imports was not expected to cause significant rises in the cost-of-living index since much of the index was food items and Ireland was a food-producing nation, and devaluation would in fact expand the markets available for Irish agricultural exports (Moynihan 1960: 356-357).

In addition to inflation and devaluation, before the end of the 1940s, the Central Bank encountered difficulties with seemingly never-ending deficits in the balance of payments. In 1947, the deficit was £40 million; in 1948, £20 million; in 1949, £10 million; and in 1950, the expected deficit at the time was £30 million. With growing public expenditures, large capital expenditures over a short period, and inflationary methods of borrowing, the country was unable to offset the growing strong demand for imports in the form of exports, especially since Ireland had limited natural resources. The expansion of the supply of money and rising income did not help either (Moynihan 1960: 372).

V. The Changing Central Bank (1954 -1979)

By 1955, it became clear to the Central Bank of Ireland that a serious deterioration in the balance of payments was in store. There was utmost need to increase production and savings and to reduce the excess of imports over exports. Banking statistics backed up the Central Bank's worries, as they showed a £26.6 million increase in domestic credit over the preceding 12 months, accompanied by a reduction, not an increase, of £4.6 million in deposits (Moynihan 1960: 425).

The difficulties with the balance of payments continued well into the 1960s. Although the gap and corresponding deficit seemingly disappeared between 1960 and 1961, deficits grew once again in the mid-1960s (Central Bank of Ireland *Annual Report* 1966: 14). By the end of the decade, there were still fluctuations between surpluses and deficits in the balance of payments (Central Bank of Ireland *Annual Report* 1969: 34).

In the 1970s, a few significant developments occurred. The Decimal Currency Act, 1970 decimalized the currency simultaneously with Britain's decimalization, which occurred on February 15, 1971. The Central Bank Act, 1971 gave the Central Bank of Ireland another monetary instrument: the ability to prescribe ratios between bank liabilities and liquid assets, which was intended to sharpen competition (Central Bank of Ireland *Annual Report* 1971: 32 and Ireland, Central Bank Act, 1971, section 23). Near the end of the decade, a highly significant event occurred when the parity between the Irish pound and sterling was finally broken.

The break in the peg of the Irish pound to sterling began on December 15, 1978, when the prime minister of Ireland announced that the country would be joining the European Monetary System, which the United Kingdom announced it would not join. When the system began on March 13, 1979, the exchange-rate mechanism of the system also began. It limited the intervention levels possible for the Irish pound to ± 2.25 percent around the central parity of the European Currency Unit (ECU), a basket of currencies of members of the European Monetary System. On March 30, 1979, market forces pushed sterling to a level such that maintaining the parity of the Irish pound would have moved the Irish pound beyond the upper intervention limits of the ECU. The Central Bank of Ireland finally broke the parity of the Irish pound with sterling that had existed for a century and a half, dating back well before Ireland's independence (Central Bank of Ireland *Annual Report* 1979: 40-41). On January 1, 1999, Ireland joined ten other European countries as a founding member of the euro, which it continues to use today.

VI. Comparing the Currency Commission to the Central Bank of Ireland

The break of the peg to the pound sterling marked a definite shift of monetary policy in Ireland. How continuous was the policy before then, and, as several observers have thought, did the changeover from the Currency Commission to the Central Bank of Ireland involve no true alteration in monetary policy for many years? To investigate, let us consider both the institutional frameworks of the two monetary authorities and the evidence their balance sheets offer.

VII. Currency Commission vs. Central Bank: Board Composition

The commissioners and directors that made up the boards of the Currency Commission and of the Central Bank, respectively, managed and directed both institutions in their functions and in their monetary policies. A comparison of the composition of the boards is of great interest, as the voices of those on the board influenced whatever policies the institutions followed.

By the Currency Act, 1927, the board for the Currency Commission consisted of a chairman, three commissioners elected by commercial banks in the Irish Free State, and three commissioners selected by the Minister of Finance (sections 15, 18). Of the three selected by the Minister of Finance, two were to represent business, industry, or trade, while the other commissioner could be a civil servant (section 18).

The Central Bank Act, 1942 stated that the board of the Central Bank of Ireland would consist of a governor, three directors to be known as "banking directors" attributed to the commercial

banks, and up to five other directors of whom no more than two could be “service directors,” that is, government employees (section 5). However, the Central Bank Act, 1971 amended this provision by reducing the total number of banking directors from three to two while increasing the number of service directors from five to six (section 53).

It can be seen in the composition of the board of the Currency Commission that the interests of the commercial banks were strongly represented, as their representatives comprised three of the six commissioners. However, with the establishment of the Central Bank in 1943, the commercial banks were reduced three of eight directors. The Central Bank Act, 1971 reduced the influence of the commercial banks further to two out of eight directors. The significance of the reduced presence of the commercial bank interest on the board can be seen in its influence on the policies of the early Central Bank in comparison to the Currency Commission.

VIII. Currency Commission vs. Central Bank: Policies and Powers

The Currency Act, 1927, Section 63, Subsection 3, specified that “it shall be lawful for the [Currency] Commission to exercise the functions of a banker in relation to the moneys for the time being in the general fund.” This blanket clause allowed the Commission to operate with as much banking power as needed. In the Central Bank Act, 1942, these blanket powers were repealed in favor of particular powers explicitly listed under Section 7 of the new act. A summary of the specific powers was provided in Section IV above.

Although the Central Bank Act, 1942 gave the Central Bank more specific banking powers than the Currency Commission had had, it is unclear that the act provided the Central Bank with more latitude in operations than the Currency Commission. In fact, come 1971, another Central Bank Act added back the general clause of the 1927 act: “It shall be lawful for the Bank, for the purposes of or through the general fund, to exercise and carry out, in addition to those functions specifically assigned to it by the Currency and Central Bank Acts, 1927 to 1971, powers and functions of a kind which, in accordance with normal banking practice, may be exercised and carried out by banks or bankers” (Central Bank Act, 1971, section 47).

The decisions that went into the Central Bank Act, 1942 also affected the standing and effectiveness of the Central Bank of Ireland in its early years. One of the primary reasons for establishing the Central Bank was to promote the expansion of credit. This included the ability to rediscount bills, buy Government securities, and impose penalties on banks holding “too large” a proportion of their resources as external assets (Moynihan 1960: 461). However, though specific powers were conferred on the Central Bank to expand credit, there was no clause in the Central Bank Act, 1942, that provided the Central Bank power to restrain the growth of credit. Thus, during the early years of the existence of the Central Bank, which were considered a failure for it, the best it could do when contractionary monetary policy was needed was to sit on the sidelines and hope for the best. Ireland was neutral in World War II, but the link of the Irish pound to sterling and the open capital account between Ireland and Britain meant that Ireland imported Britain’s expansionary wartime monetary policy.

Another decision that negatively influenced the effectiveness of the Central Bank was that it did not function as the government's main banker. The Central Bank accordingly too long lacked the full authority, prestige, and power to influence the government and commercial banks, which according to one governor of the Central Bank negatively affected its performance in guarding the integrity of the currency (Moynihan 1960: 215).

The composition of the financial system also reduced the effectiveness of the powers of the Central Bank. For example, the powers of the Central Bank could be used for credit control, though they were primarily designed for safeguarding bank deposits (Moynihan 1960: 473). But due to the lack of a sufficiently broad money market, effective open market operations were impossible for the Central Bank to accomplish (Moynihan 1960: 473). Furthermore, since the commercial banks in Ireland had extensive liquid sterling assets and reserves at their disposal (Moynihan 1960: 303, 473), open market operations had limited effect on them. (Economists adhering to efficient-market views might regard the ineffectiveness of open market operations as a strength rather than a shortcoming of the Irish monetary system.)

The inability to limit credit during the years when limitation was needed, the lack of the status and powers traditionally attributed to a central bank such as serving as the government's bank, and the unique composition of the Irish monetary structure meant that the Central Bank of Ireland was limited to functioning similarly to the Currency Commission it was supposed to replace. In fact, some commentators claimed that the early Central Bank of Ireland was merely a name change, and the Central Bank did little more than issue currency and manage the holding of assets against notes issued without addressing the greater economic trends at play (Moynihan 1960: 224). However, it is important to remember that the Central Bank Act, 1942 limited the functions of the Central Bank and only provided it with expansionary monetary policy tools, not contractionary tools.

IX: Balance Sheet Data

Besides examining the similarities and differences between the legal structure of the Currency Commission and the Central Bank of Ireland, we can also compare their balance sheets. Data from the Currency Commission period, which was from 1927-1943, are from Krus and Schuler (2014), who compiled the data from the Commission's annual reports. (The first annual report of the Currency Commission was issued in 1928 and the last in 1942.) Data for the Central Bank of Ireland from its founding in 1943 to when the link with sterling was broken in 1979 were compiled by me from the balance sheets found in the *Statement of Accounts* and the annual reports of the Central Bank. I standardized the combined data in a simplified balance sheet to make comparisons over time and analysis of the most important points easier.

The continuous annual balance sheet data from 1928-1979 provide more complete statistics for the period than are available from the Central Bank's website or the International Financial Statistics database of the International Monetary Fund. This paper uses the balance sheet data to analyze how closely both the Currency Commission and the Central Bank conformed to an

orthodox currency board and to compare the Currency Commission to the Central Bank of Ireland in its first three-and-a-half decades of existence. Other researchers may find the data useful in different types of analysis.

X: Currency Board Orthodoxy Tests

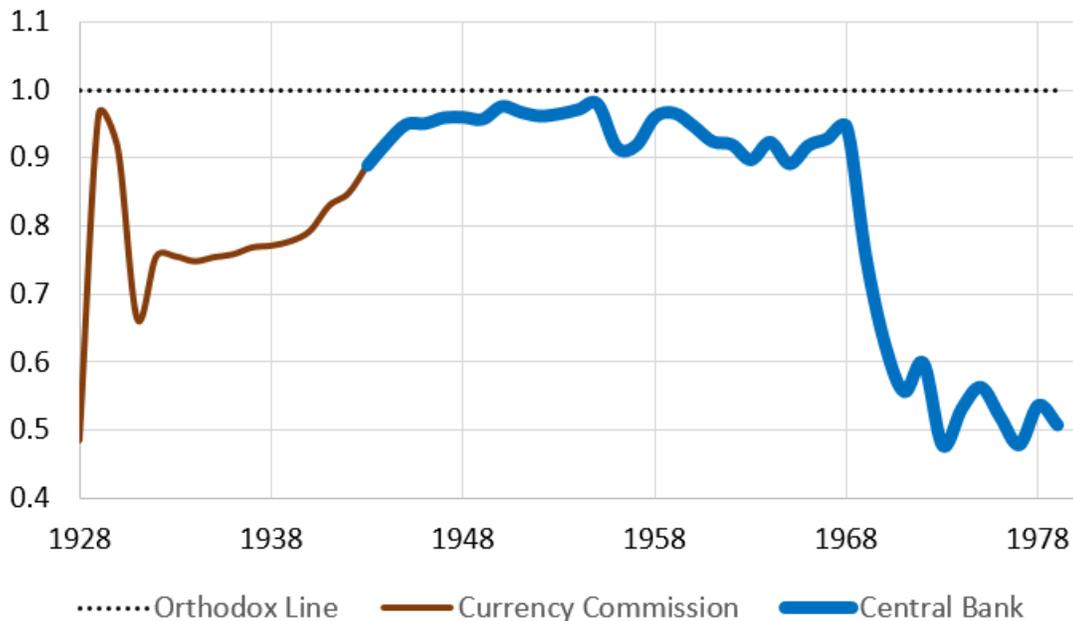
The analysis in this paper will consist of tests of currency board orthodoxy based on balance sheet data. The tests will probe how closely both the Currency Commission and the Central Bank conformed to the ideal of an orthodox currency board. This fundamental analysis on the primary source explores the topic of currency boards in a different way from previous literature on Irish financial structure from 1928-79, including a paper written by Patrick Honohan (1977), who would later become governor of the Central Bank.

The three most important characteristics that define an orthodox currency board are a fixed exchange rate, no exchange controls with the anchor currency, and 100 percent foreign reserves against the monetary base (at least at the margin) (Hanke and Schuler 2015: 2-7). The tests below explore how closely the Currency Commission and Central Bank of Ireland reflected orthodox currency board characteristics and how closely the data support the arguments of some previous observers that at least in the early years of the Central Bank of Ireland, its policy differed little from that of the Currency Commission.

X.I: Foreign Assets to Total Assets

One test of currency board orthodoxy is the ratio of foreign assets to total assets. In an orthodox currency board, the ratio should be around 1 (100 percent), as the currency board would hold few or no domestic assets, and thus would hold only foreign assets. The chart below plots the

Ratio of Foreign Assets to Total Assets, 1928 - 1979



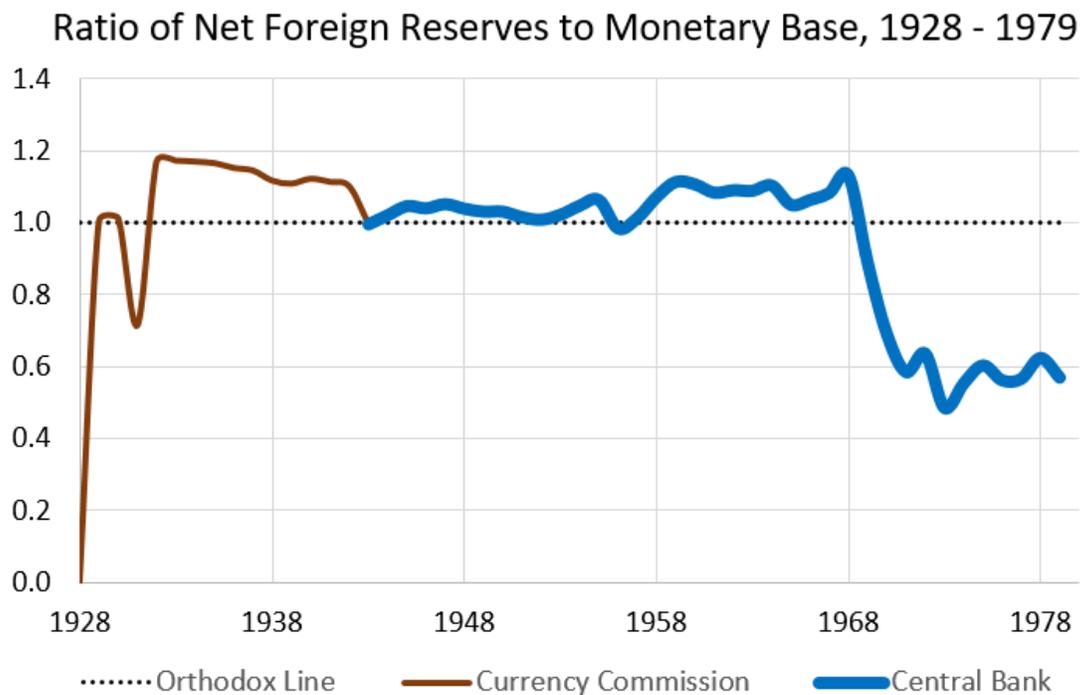
data. The thin brown line shows the data from the Currency Commission period, while the thick blue line shows the data from the Central Bank of Ireland period. The black dotted line represents where an orthodox currency board would keep the ratio, at 1.

As one can see in the chart, the Currency Commission in its 15 years of existence had a lower ratio of foreign assets than the Central Bank of Ireland's in its' first 20 years of existence. Thus, the Central Bank of Ireland actually conformed more to an orthodoxy currency in this regard than the Currency Commission. However, after 1968, the Central Bank of Ireland held about half of its assets in foreign holdings and domestic holdings, diverging from an orthodox currency board.

The divergence seen in the chart above is of interest. The Central Bank's annual reports says the Central Bank started implementing changes to the banking system in preparation for an Irish money market system starting in 1968 (Central Bank of Ireland *Annual Report 1970*: 54-55). The effects of the development on the monetary system can be seen in the Central Bank's balance sheets. There was a centralization of external monetary reserves (primarily into gold) and the provisioning of increased internal sources of liquidity for money market facilities, which appear in the balance sheet as a marked increase in rediscounted bills and money at call and at short notice. Thus, one can conclude that in promoting the development of a money market – which the first Currency Commission identified the lack of as a strong reason for not having a central bank – the Central Bank of Ireland diverged from currency board orthodoxy.

X.II: Net Foreign Reserves to Monetary Base

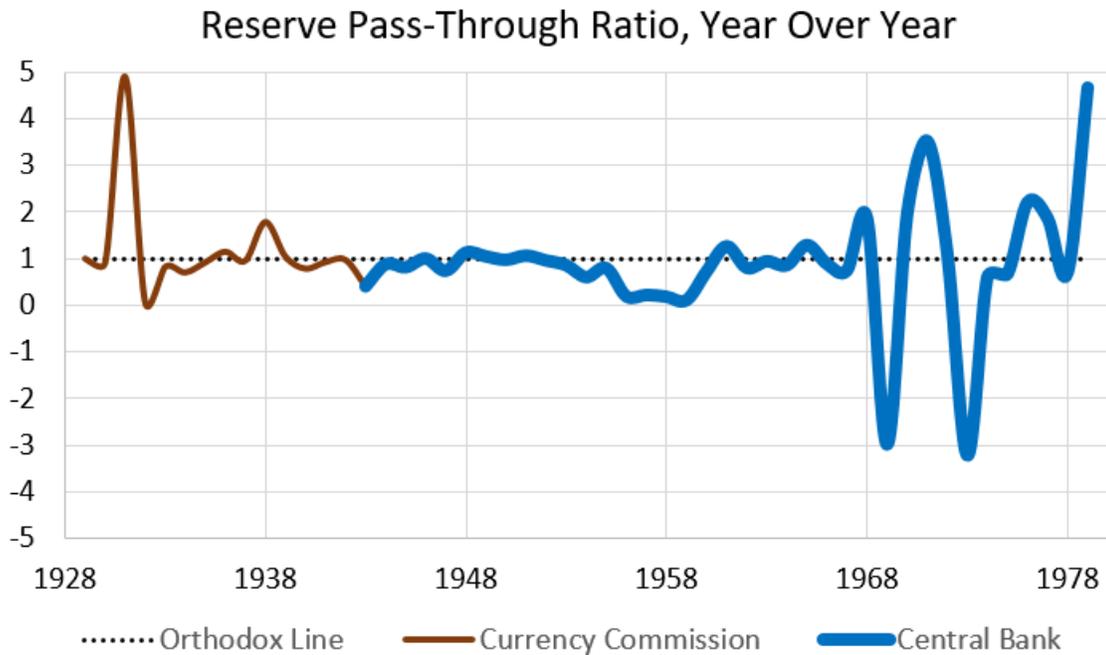
A second test of currency board orthodoxy is the ratio of net foreign reserves to the monetary base. Net foreign reserves consist of the foreign assets minus the foreign liabilities. The monetary base consists of the notes in circulation, coins (if any), and demand deposits of financial institutions at the monetary authority. An orthodox currency board maintains a ratio of 1 – indicated by the black dotted line – between net foreign reserves and the monetary base. The ratio may not be exactly 1 because of changes in the market valuation of assets or other factors, but a ratio below 0.8 or above 1.2 creates a presumption of unorthodoxy.



As one can see in the chart above, the ratio was close to 1 except in 1928, the first year of the Currency Commission, and 1931. At the start of the Central Bank of Ireland in 1943, it can be seen that the ratio fell below 1, but by the following year, the ratio was maintained around or slightly above 1 until 1969. Thus, one can see that for the majority of the years of the Currency Commission and the some 25 years of the early history of the Central Bank, the institutions conformed to currency board orthodoxy with regard to the ratio of net foreign reserves to monetary base.

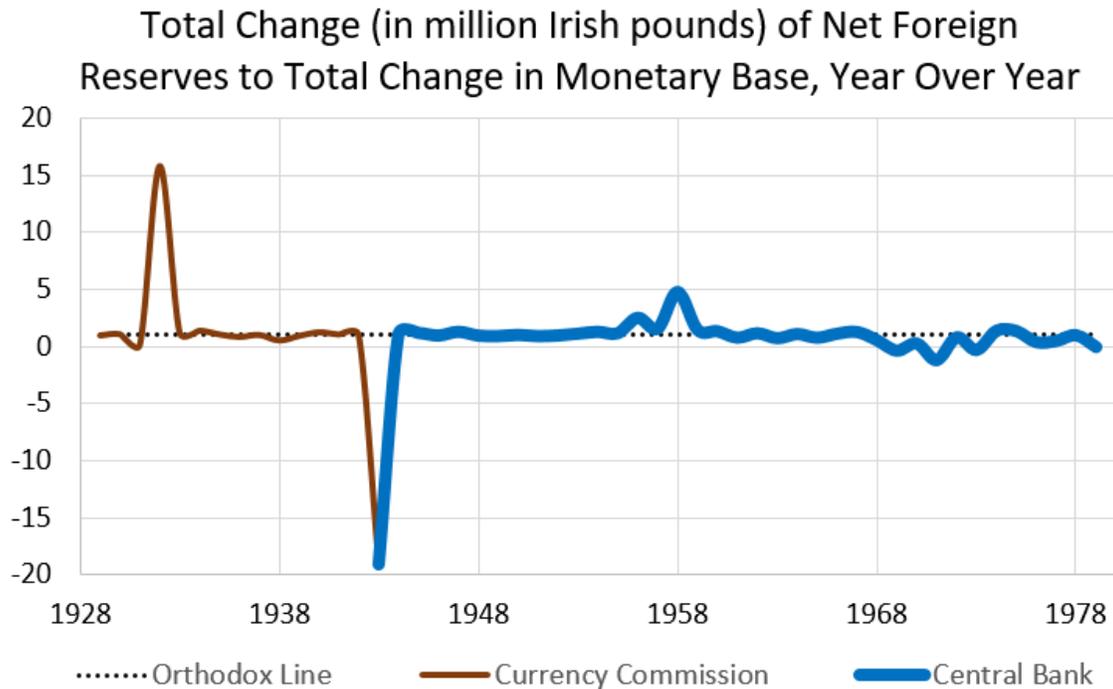
X.III: Reserve Pass-Through

A third test of currency board orthodoxy is the reserve pass-through ratio, which is the total change in net foreign reserves divided by the total change in the monetary base. The preferred way of measuring the reserve pass-through ratio is year over year to eliminate or reduce the effect of seasonal or idiosyncratic factors that may introduce noise. Thus, the data start in 1929, the year after the first annual balance sheet. In an orthodox currency board, the ratio should stay at around 1. It can be seen that the ratio was generally around 1 from about 1935-1942 under the Currency Commission and from 1944-1967 under the Central Bank of Ireland. Thus, these years were the ones that most conformed to an orthodox currency board. It is notable that after 1967, wide fluctuations can be seen from year to year both above and below 1, which illustrates the divergence from currency board orthodoxy.



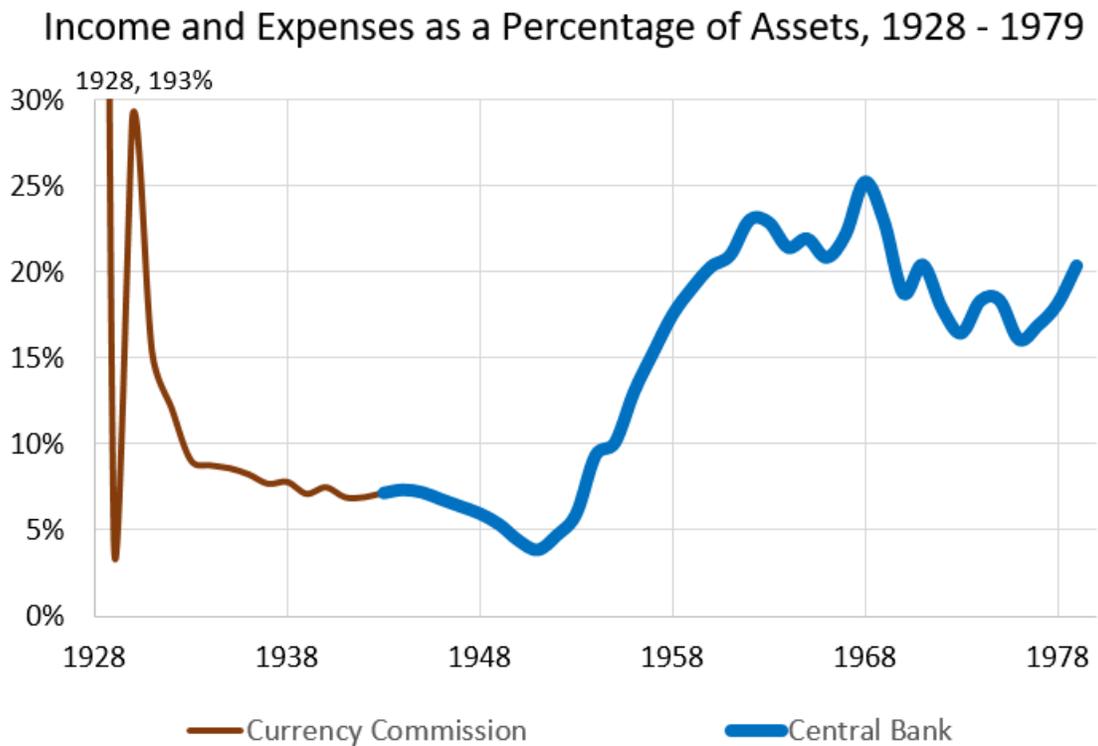
X.IV: Total Change of Net Foreign Reserve to Monetary Base

A fourth test of currency board orthodoxy is the total change of net foreign reserves to the total change in monetary base in Irish pounds and on a year-over-year basis. Again, an orthodox currency board would maintain a ratio close to 1. This in fact happened except for 1931 during the Currency Commission era and in 1943 during the transition from the Currency Commission to the Central Bank. Up until 1968, except for a rise to about a ratio of 5 in 1958, the Central Bank of Ireland stuck close to a ratio of 1. More variability can be seen after 1968. Thus, for most of the years of the Currency Commission and the first twenty-odd years of the Central Bank of Ireland, it conformed to a currency board according to this orthodoxy test.



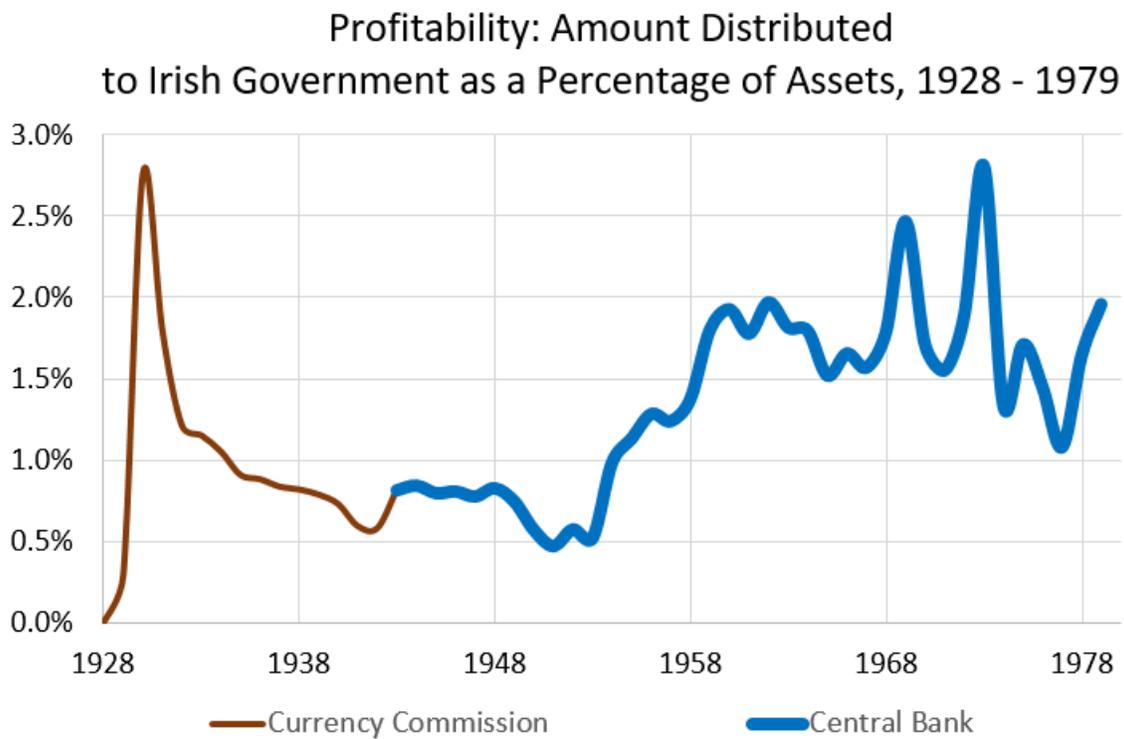
X.V: Income and Expense as Percentage of Assets

Now we move on to analysis that is not directly related to currency board orthodoxy but is of interest because it addresses whether the Central Bank was costlier or more profitable than the Currency Commission. It can be seen that income and expenses made up a larger percentage of assets during the mid-to-late years of the Central Bank of Ireland. In the underlying data, it can be seen that this is because of increasing expenditures by the Central Bank of Ireland, which are categorized under "Other or Unspecified." Overall, it can be seen that except for the first year of the Currency Commission, when certain costs of establishing a new institution arose, the ratio hovered around 10 percent from 1930 to 1952, but then rose to hover around 20 percent from 1958 to 1979.



X.VI: Profitability

Finally, let us examine profitability, specifically the amount distributed to the Irish government as a percentage of assets. In the very early years of the Currency Commission, distributions can be seen to be about two to three times higher as a share of assets in its later years. This is probably due to the issuance of new Irish coins to replace British coins in circulation, which provided a one-shot boost. However, profitability stayed at less than 1 percent until the transition to a central bank was completed and the 1950's came around. Then, profitability rose again. Overall, profitability was higher during the later years of the Central Bank than in its early years, and the early years of the Central Bank were similar to about the last decade of the Currency Commission.



XI. Conclusion

The early Central Bank of Ireland functioned much like a currency board; it continued the policies it inherited from its predecessor, the Currency Commission, which also functioned like a currency board. On paper, there were some significant legal differences between the two monetary authorities, but the data show how alike they were. It was only after 1968 that the Central Bank began to behave much differently from a currency board, which corresponds to when the Central Bank started establishing the foundations of an Irish money market system. Then, in 1979, one of the main pillars dating back to the Currency Commission period and earlier was broken when the one-to-one exchange rate between the Irish pound and sterling ended.

One sees the distinct differences between a currency board and central bank through the analysis of the Currency Commission and Central Bank of Ireland from 1927-1979. Even though a central bank can at times operate in practice like a currency board, there is no guarantee of durability. Having been granted the powers and flexibilities bestowed on a central bank, the Central Bank of Ireland could stop acting like a currency board from 1968 and onwards, moving assets from Associated Banks to the central bank, increasing credit, and establishing the foundations needed for a money market system. Thus, a distinct currency board system, when needed, should be established to conform to currency board orthodoxy in lieu of a central bank that acts like a currency board.

XII. References

Photographs of the balance sheets of the Currency Commission can be found in the Digital Archive on Currency Boards. Krus and Schuler (2014) digitized them. I have photographs of the balance sheets of the Central Bank of Ireland and will share them with other researchers on request. See the accompanying spreadsheet workbook for my digitization of the original Central Bank balance sheets as well as a standardized balance sheet covering the Currency Commission and the Central Bank.

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