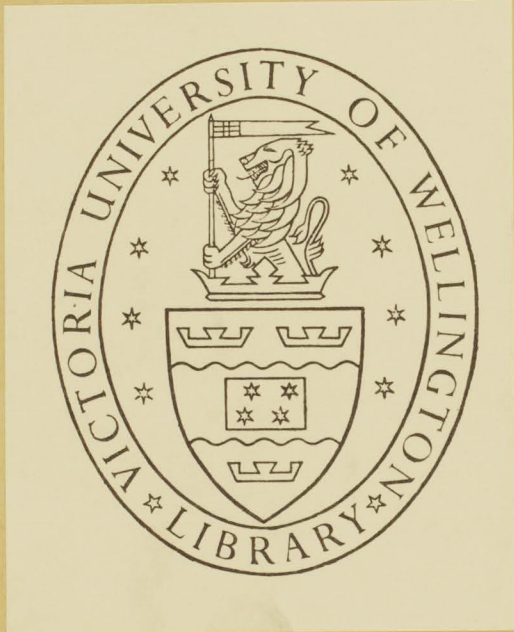


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(1) International Financial Statistics Vol. XXVI, No 5 May 1973 at p 268

(2) Export receipts from wild products, meat and wool in 1972 were \$333.7 million, \$462.3 m, \$308 m, respectively comprising together 79 per cent of total exports. Other primary production notably forest products of the above industries, fish, fruit and honey comprised another 17 per cent EMU Bulletin April 1973 at p. 65.

LEGAL ASPECTS OF STATE INTERVENTION IN THE FINANCING
OF NEW ZEALAND'S EXPORT TRADE

JAMES RICHARD ALAN STEVENSON

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NEW ZEALAND

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Introduction

Earnings from exports comprise 25 per cent of New Zealand's gross national product. (1) On a per capita basis therefore, New Zealand is one of the foremost trading countries in the world, but in contrast to other developed market economy countries it relies heavily on a narrow range of raw or semi processed primary commodities for its export income and its economic development. (2) Thus the production of agricultural commodities for export has always had an important influence on fiscal and monetary policies adopted by successive governments. In addition where credit facilities for farm producers and processing companies have not been regarded as adequate or appropriate to the importance of the agricultural sector in the economy, the Government has developed institutions to correct this situation.

The preoccupation with diversifying the economy through industrialisation and through the growth of manufactured exports which has characterised the thinking of both political parties since the late 1950's has also led to monetary and fiscal policies being directed to promoting manufactured exports. State finance and insurance companies were established to cover the particular needs of new and developing exporting industries, where their financing or insurance needs might not have been readily undertaken by exist-

(1) International Financial Statistics Vol. XXVI, No 5 May 1973 at p 268

(2) Export receipts from mild ^k products, meat and wool in 1972 were \$333.7 million, \$482.3 m, \$308 m, respectively comprising together 75 per cent of total exports. Other primary production notably forest products of the above industries, fish, fruit and honey comprised another 17 per cent RBNZ Bulletin April 1973 at p. 65.

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ing private institutions providing similar services.

This paper is concerned with certain legal aspects of State intervention in this area. The legal framework within which the Government executes its monetary policies will need to be examined. This largely involves consideration of legislation. While State intervention is invariably accompanied by statutory law and subsidiary forms of legislation it is also affected by aspects of law which have not received statutory definition. It is first necessary to examine briefly the State institutions with an interest in pre-shipment and post-shipment finance and their relationship with the Government.

Some stocking and working capital requirements of farmer's have traditionally been met by trading banks and stock and station trading companies which conduct specialised banking operations ancillary to their main wool, livestock and shipping business. (3) These institutions are subject to extensive control by the Reserve Bank

- (3) The NZ Financial System Monetary and Economic Council, Report No. 10 March 1965.
- (4) A special rural division of the SAC has recently been established. See Budget Statement 14 June 1973 Govt. Printer Wellington.
- (5) The financial operations of these companies involves the maintenance of current accounts, the acceptance of time deposits and the granting of secured and unsecured advances. Current accounts are utilised by farmers to hold the proceeds of the sale of produce and to which farm and personal expenses are debited. Unsecured advances are generally secured and are not intended to be repaid within the normal seasonal production period. These advances are part of a farmers permanent capital. Temporary unsecured advances are made in the anticipation of the receipt of seasonal income. Unsecured advances are generally equal to about 60 per cent of bank advances to farmers illustrating the importance of stock and station agents as sources of farm credit. Reserve Bank of NZ pub. Money and Banking in New Zealand 1963 Govt. Printer p. 26.

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1. State intervention in the Agricultural Sector

There are special characteristics of farming operations which give rise to credit needs which differ significantly in nature from those of other primary borrowers and lenders in the economy. In addition farm income receipts are both subject to marked seasonal concentration and may vary sharply from year to year because of fluctuating prices in export markets. (3) The Government through its agencies the State Advances Corporation (4) and State Life Insurance companies plays the principal role in lending to the farming sector mainly for the purchase of land.

Some stocking and working capital requirements of farmer's have traditionally been met by trading banks and stock and station trading companies which conduct specialised banking operations ancillary to their main wool, livestock and shipping business. (5) These institutions are subject to extensive control by the Reserve Bank

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- (3) The NZ Financial System Monetary and Economic Council, Report No. 10 March 1966.
- (4) A special rural division of the SAC has recently been established. See Budget Statement 14 June 1973 Govt. Printer Wellington.
- (5) The financial operations of these companies involves the maintenance of current account, the acceptance of time deposits and the granting of secured and unsecured advances. Current accounts are utilised by farmers to hold the proceeds of the sale of produce and to which farm and personal expenses are charged. The surplus may be placed with the companies on fixed deposit. Continuing advances are generally secured and are not intended to be repaid within the normal seasonal production period. These advances are part of a farmers permanent capital. Temporary unsecured advances are made in the anticipation of the receipt of seasonal income. Unsecured advances are generally equal to about 60 per cent of bank advances to farmers illustrating the importance of stock and station agents as sources of farm credit. Reserve Bank of NZ pub. Money and Banking in New Zealand 1963 Govt. Printer p. 26.

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in terms of the Reserve Bank Amendment Act 1973. (6) The greatest requirement for finance comes from the industries processing and transporting primary produce. The trading banks are the key financial institution in the private sector providing seasonal finance for agricultural and processing industries. The trading banks have a unique function in the intermediation process and with the aid of the monetary authorities are able to accommodate large seasonal fluctuations in the needs of primary industry. (7) Overseas trading of certain of these agricultural products is however in the hands of statutory marketing authorities, whose financial requirements are accommodated by the Reserve Bank.

(7) The DFC had its origins in the recommendations of the Industrial Development Conference 1960 and the recommendations of the Tariff and Development Board concerning industrial development in 1962. Although established by an Act of Parliament the corporation commenced as a mixed enterprise. Of the \$2 million capital which had been issued up to 1971 from the \$4 million authorized by the Act, the Reserve Bank's statutory required 30 per cent (\$1.2) had been taken up with the remaining 70 per cent taken up by the trading banks and insurance companies. The Corporation was also limited to being a lender of last resort. (s. 2 (1)) This limitation was repealed by an amending Act in 1970. The present Government bought out the shares of private interests in 1973 and at the time of writing had introduced a bill into Parliament validating the takeover and reconstituting the Corporation. The bill increased the nominal capital to \$10 million and contains a new provision authorizing the Minister of Trade and Industry to give the corporation directions on general policy since amendments have also been made to the corporation's functions and powers to enable it to encourage...

(6) See Part II

(7) Monetary Policy and the Financial System NZ Monetary and Economic Council Report No. 24.

(8) The Budget Statement, 4 June, 1973. Govt. Printing Office.

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Industrial Sector

2. The Development Finance Corporation

The major instrument of direct government intervention into the field of leading for the production of manufactured and capital goods for export is the State owned corporation the Development Finance Corporation. (7) Although restrictions, statutory or otherwise, have until recently been placed on the lending activities of the Corporation, the intention of the present government is for the Corporation to be 'the principal channel through which assistance is given to industry on a selective basis.' (8)

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- (7) The DFC had its origins in the recommendations of the Industrial Development Conference 1960 and the recommendations of the Tariff and Development Board concerning industrial development in 1962. Although established by an Act of Parliament the corporation commenced as a mixed enterprise. Of the \$2 million capital which had been issued up to 1971 from the \$4 million authorised by the Act, the Reserve Bank's statutorily required 30 per cent (s.4) had been taken up with the remaining 70 per cent taken up by the trading banks and insurance companies. The Corporation was also limited to being a lender of last resort. (s.8 (1)) This limitation was repealed by an amending Act in 1970. The present Government bought out the shares of private interests in 1973 and at the time of writing had introduced a bill into Parliament validating the takeover and reconstituting the Corporation.

The bill increases the nominal capital to \$10 million and contains a new provision authorising the Minister of Trade and Industry to give the corporation directions on general policy. Minor amendments have also been made to the corporation's functions and powers to enable it to encourage NZ industries to enter in joint ventures in overseas markets where these would benefit the NZ economy. Development Finance Corporation Amending Bill 1973. It has recently entered the short term deposit taking arena. 'Sunday Herald' August 12 1973.

- (8) The Budget Statement, 4 June, 1973. Govt. Printing Office.

see p. 10

The lending functions of the Corporation of relevance to the financing of export production are set out in s.6 of the principal Act. In exercising its functions the Corporation is to lend primarily for medium or long term ⁽⁹⁾ periods and to give particular attention to the needs of small and medium sized businesses. It is also to encourage the establishment or expansion of industries which will benefit inter alia the economy as a whole or which will otherwise benefit the balance of payments. ⁽¹⁰⁾ Further to lending for the purposes of export production in New Zealand the Corporation may lend for the purpose of 'assisting persons to set up or expand development projects overseas that will benefit the New Zealand economy, ⁽¹¹⁾ In order to carry out its functions the DFC may also enter into or participate in underwriting or sub-underwriting in respect of the issue of shares and debentures, or give guarantees. It may also participate in a joint lending arrangement. ⁽¹²⁾

The new relationship between the Government and the DFC is illustrated by the use of a different technique enabling the DFC to administer two schemes designed to assist export production.

(9) DFC loans are usually granted for terms between 7 and 12 years and in most cases borrowers are excused from making capital repayments during the first year.

(10) In submitting a request for finance the applicants are asked to comment on any aspects of export earnings in the proposal. Guidance sheet for a request for finance DFC sheet, Dev, 2/1. The DFC lenders policy statement also states that opportunities for export production will be favourable factors influencing a DFC decision.

(11) s 6. (2) (d) inserted by the DFC Amendment Act 1970 s.2.

(12) s 7.

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Provision was made in the 1973 budget ⁽¹³⁾ for the institution of an export suspensory loan scheme and a mortgage guarantee scheme, the administration of which is vested in the DFC under delegated authority from the Government.

The export suspensory loan scheme contains a number of interesting features. ⁽¹⁴⁾ The broad features of the scheme are that for certain investment projects designed to achieve a high export performance, a grant of 40 per cent of the capital cost of plant and machinery is available. The grant takes the form of a suspensory loan subject to interest at rates normally charged by the DFC. ⁽¹⁵⁾ The suspensory loan is to be written off in full if 40 per cent of the output of the project is exported over any 3 year period within the first five years. Qualifying projects are normally restricted to those with a capital cost of not more than \$100,000 giving a maximum grant of \$40,000. Consideration may also be given by the DFC to special cases however involving amounts in excess of this maximum but the authorisation of Government is required. The loan does not crystallise into a grant until a submission is made by the borrower supported by satisfactory evidence that the required percentage of exportable production has been achieved. The DFC however is vested with a discretion to consider a proportionate grant if the exports exceed 20 per cent of the planned production but fall short of the 40 per cent target. If the

(13) Budget Statement op cit.

(14) DFC Sheet: Advice to Manufacturers - Export suspensory Loans July 1973.

(15) For projects which are strongly developmental in character, financially viable and with a sound credit rating, an interest rate in the vicinity of 8 per cent is normally charged.
Ibid

applicant is unable to export 20 per cent of planned production the repayment terms come into effect.

A prerequisite to qualifying under the scheme is related to another statutory regulation.

The scheme only applies to purchase of new plant and machinery to be used in a project for the manufacture of products of a type which qualify under the increased Export Tax incentive scheme. (16) In respects other than the special developmental and export promotion characteristics, the loan is treated on a strictly commercial basis, particularly in terms of credit worthiness, the risk factors involved, and security available.

The mortgage guarantee scheme as its name suggests involves a guarantee by the DFC to the mortgagee of repayment and interest of up to \$100,000 for buildings owned and occupied by small and medium companies which are exporting or are able to obtain a high level of productivity. In this way the mortgagor is able to reduce the gap between the cost of building and the funds normally available to this type of borrower on a first mortgage.

A loan agreement for \$8 million between the DFC and the

(16) i.e. generally for goods of a sophisticated nature based on processing of locally produced materials and food.

(17) Annual Report of the Department of Trade and Industry Appendices Journals N.O. Sep. 2.44 1972.

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International Bank for Reconstruction and Development in 1971 demonstrates the use of the Corporation's borrowing powers under s17. Under the section the Corporation is empowered to borrow up to an amount not exceeding five times the authorised capital of the Corporation. If it seeks a guarantee from Government, however the loan is to be subject to such terms and conditions as the Minister thinks fit. The negotiation of the loan was in fact initiated by Government and negotiated by officials of the Minister's department. Under the terms of the agreement which is guaranteed by Government in terms of s.18, the loan is to be used to finance the imported content of approved development projects in New Zealand; the loan is particularly intended to assist in the provision of long term pre-shipment finance of forest industries and meat processing. (17)

Government has also had recourse to the power under s 18 (a) of the Act enabling the Minister of Finance to advance money to the Corporation. In 1972 the Corporation obtained a loan from the Government on the terms that it be relented to meat companies to assist in financing the renewal of meat processing plants to enable them to reach more stringent hygiene requirements.

It is apparent therefore that the Corporation is playing an increasing role in the provision of pre-shipment finance. Despite

(17) Annual Report of the Department of Trade and Industry Appendices Journals H.O. Rep. H.44 1972.

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PART II

a recommendation by the National Development Conference, (18) the Corporation has not yet been permitted to engage in the provision of post-shipment export finance in cooperation with trading banks and the Reserve Bank. In any event its specialised function as a development bank would seem to disqualify it from entering this field.

The Bank acquired responsibility in this area by a consequent facility however, is with EXGO. Of the powers vested in it by statute, relating to the regulation and control of credit in New Zealand. It plays both a direct and an indirect role in promoting trade, on behalf of the Government, either role involving recourse to the organic law of its institution. The Reserve Bank of New Zealand Act 1964 is the fundamental source of central bank law in New Zealand, but in exercising its powers and in its operation the Bank is also affected by other domestic sources of law namely legislation applied to other banks and common law. (1) Certain rules of international law also affect the Bank in performing its task as banker both to the Government and to certain statutory marketing authorities.

For the most part it is not possible to isolate the exercise of law by the Reserve Bank in the field of export credit to promote trade from that relating to the creation or restriction of ex-

(18) Annual Report of the DFC 1968/69

(1) For consideration of the comparative sources of domestic law which affect central banks see Hans Aufricht, Comparative Survey of Central Bank Law, London 1965

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PART IIThe Central Bank of New ZealandIntroduction

The primary instrument of the State in the financing of New Zealand's export trade is the Reserve Bank of New Zealand. The Bank acquires responsibilities in this area as a consequence of the powers and functions vested in it by statute, relating to the regulation and control of credit in New Zealand. It plays both a direct and an indirect role in promoting trade, on behalf of the Government, either role involving recourse to the organic law of its institution. The Reserve Bank of New Zealand Act 1964 is the fundamental source of central bank law in New Zealand, but in exercising its powers and in its operation the Bank is also affected by other domestic sources of law namely legislation applied to other banks and common law. (1) Certain rules of international law also affect the Bank in performing its task as banker both to the Government and to certain statutory marketing authorities.

For the most part it is not possible to isolate the exercise law by the Reserve Bank in the field of export credit to promote trade from that relating to the creation or restriction of expansive credit conditions generally. The exercise of its powers

(1) For consideration of the comparative sources of domestic law which affect central banks see Hans Aufricht. Comparative Survey of Central Bank Law, London 1965

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in respect to domestic monetary policy inevitably has consequences as regards the ability of the trading banks to finance export credits. On the other hand the Bank in certain situations becomes a party to specific export credit transactions. Before proceeding it is necessary to examine the constitution and functions and powers of the Bank.

2. The Structure of the Reserve Bank

The organic law of the Bank is contained in the Reserve Bank of New Zealand Act 1964. (2) Under s 3 the Bank is designated as a body corporate attached with certain attributes of a body corporate (3) management of the Bank the Board of Directors are

(2) The legislative history of the Reserve Bank commenced with the Reserve Bank Act 1933. Despite early proposals in 1886 and in 1913 for the establishment of a Central Bank, these proposals were not seriously considered until the depression in 1930 when the NZ Government invited Sir Otto Niemeyer, formerly of the British Treasury and a recognised expert on central banking to report on New Zealand's banking and currency system. On the basis of the Niemeyer report (Banking and Currency in New Zealand, Wellington Government Printing Office 1931) the Reserve Bank of New Zealand Act was passed by the then Reform Government which constituted the Bank as a body corporate with a share capital of 100,000 publicly subscribed shares of 5 pounds each and a Reserve Fund of 1 million pounds provided by the State. One of the first acts of the Labour Government was to pass the Reserve Bank Amendment Act 1936 which enabled the shares to be purchased by Government to make it a fully State owned institution. In addition a number of new powers were granted to the Bank notably in respect of controlling trading banks and the adherence of the Bank to Government monetary policy. Its powers were further strengthened in 1939, in 1946 (by the Finance Act No. 2), and in 1960. The present Act has been substantively amended by the Reserve Bank Amendment Act 1973 passed on 1 September which gives the Bank much wider powers in respect of the regulation of financial institutions other than banks. For a comprehensive economic history of the Bank see G R Hawke - Between Governments and Banks, Wellington Government Printer 1973.

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declared by the Act to constitute the body corporate. (4) The body corporate is also designated a bank. It has a legal status however distinct from that of other banks. Except for certain provisions the Banking Act 1908 is expressly declared not to apply to it. (5) The only provisions which are declared by the Act to apply are ss 19-26 of the Banking Act and s 3 of the Banking Amendment Act 1935 (relating to bank holidays, hours of business and book entries) and s 9 (1) Statutes Amendment Act 1946 (relating to banking hours.) In addition in the event of any conflict between the Act and the provisions of the Banking Act 1908 or for that matter any other Act relating to any bank or to the business of banking, the provisions of the Reserve Bank Act are to apply.

A further immediate distinction between the Bank and other banks is that it is restricted from conducting business which other banks may contemplate in the course of their business. Except with the authority of the Governor-General it is prohibited from engaging in trade, or otherwise have a direct interest in any commercial, industrial, financial or similar undertaking. Similar to other banks it is not permitted to purchase or subscribe for the shares of any trading bank or any financial institution in New Zealand or elsewhere. It is also prohibited from lending

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- (3) The Bank is however, exempted from public taxation (not including local rates) to the same extent as the Crown, s 46. The Companies Act has however limited application to banks see Part I.
- (4) s 4. The directors comprise the Governor, the Deputy Governor, the Secretary to the Treasury and seven other directors appointed by the Governor-General. Certain categories of persons are disqualified from holding the office of director under s 5. Directors are not personally liable for any act done by the Bank or by any director in good faith in the course of the operations of the Bank s 16.
- (5) Reserve Bank Act s 47 (2). The former provision to this effect

money on the security of any shares that the Bank is prohibited from purchasing. (6)

3. The Primary Functions of the Bank

There is no ready description of the role of a central bank and the entity is invariably defined by listing the objectives of the institution and on the other hand its functions and powers. (7) The essence of central banking has however been described as the control of the monetary system to serve the interests of the general public. These interests are translated into specific objectives which evolve with the changing economic demands of society (8) Recourse must now be had to the Act to ascertain these specific objectives.

The primary functions of the Bank are set out in s 8. (9) While certain functions are enumerated, s 9 (1) makes it clear that the list is not intended to be exhaustive. The primary functions under the new s 8 are:

- (1) a) To act as the central bank for New Zealand; and
- b) To ensure that the availability and conditions of credit provided by financial institutions are not inconsistent with

now repealed was contained in the Banking Act itself.

- (6) Reserve Bank Act s 10.
- (7) Hawke op cit. p. 9.
- (8) H.H. Binhammer, Money, Banking and the Canadian Financial System. Methven 1972 at p 215.
- (9) as substituted by s 5 of the Reserve Bank Amendment Act 1973.

the sovereign right of the Crown to control money and credit in the public interest;

- c) To advise the Government on matters relating to the monetary policy, banking credit, and overseas exchange; and
- d) Within the limits of its powers, to give effect to the monetary policy of the Government as communicated in writing to the Bank.

The Act also makes it clear that Government's monetary policy should be directed to the maintenance and promotion of economic and social welfare in New Zealand. Although the concept is not specifically defined it is stated that the policy should be related to the desirability of promoting the highest level of production, trade and full employment ⁽¹⁰⁾ and of maintaining a stable internal price level. The objectives are in fact mutually dependent and while a specific objective is the promotion of trade (both internal and external) the realisation of the other broad objectives of economic growth, a high degree of production and the need to maintain a stable internal price level are equally necessary conditions for the stimulation of exports.

Similarly it is not possible to isolate any particular powers and functions which are of relevance only to the export sector. In fact the Bank has been invested with a considerably broader mandate than that accorded to it by the original Act of 1933. It may subject to specific exclusions contained in s 10 ...' do any other business or exercise any other powers incidental to or consequential on any of the provisions of the Act'... Specific functions and powers however, are granted to the Bank in many

(10) s 8 (2)

ways similar to other banks, Under s 9 it may 'establish credits', buy, sell, discount and rediscount, bills of exchange, promissory notes and with the prior consent of the Minister, underwrite loans. Unlike banks it is empowered to give or accept guarantees in any currency and on terms providing for repayment or payment, as the case may require in the same or any other currency. Each of these particular empowering classes have in fact been used for the benefit of the export sector either in association with its specific powers in the area of monetary policy or independently of those powers.

The Legal Relationship between the Bank and Government

At the time of the establishment of the Bank in 1933, the traditional view of economists and the then Government was that the Bank should have a large measure of independence from Government control and political interference. ⁽¹¹⁾ Several amendments have however been made to the original section ⁽¹²⁾ reflecting this thinking, which have evidenced differences between the

(11) F.W.Holmes Money, Finance and the Economy Heineman 1972 at p. 83.

(12) s 12 RB Act 1933.

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two major political parties over the extent of the control that should be exercised by Government. (13) Accordingly the recent amendment to the Act has also made a number of substantive changes. The present Act requires the Bank not only to give effect to the monetary policy (14) of the Government but it also grants the Minister of Finance greater powers in respect to the management of the Bank's operations.

(13) The precise relationship of the Bank to Government was not given statutory definition until 1936 when the s 10 of the RB Amendment Act 1936 repealed the former s 12. The drafting of the new clause however did not have the desired effect and was drawn more definitively in a further amendment in 1939. This required the Bank to give effect to any decision of the Government relating to the functions or business of the Bank. In addition it was required to have regard to representations by the Minister of Finance. In 1950 the National Government removed from the Minister of Finance to the House of Representatives the power to give specific instructions on the management of the Bank. The Labour Government responded by passing the RB Amendment Act 1960 which substituted the 1939 amendment for the earlier clause, almost in its entirety. The 1964 Act removed the clause and made no specific provisions for the instruction management. The RB Amendment Act 1973 (s 5) made a number of substantive changes to s 8 Act which in effect go further than any earlier clauses. That the controversy concerning political interference in the Banks operation is still alive, is also illustrated by the fact that major portion of the debates on the amending Act dwelt on the proposal to have a Ministerial appointee on the Executive Committee of the Board of Governors, see Hansard NZPO June 13. For the history of the constitutional relations between the Government and the Bank 1933-82 see Hawke op cit pbl et seq.

(14) The Government's monetary policy is to conform with certain objectives also. These are however couched in such wide terms, that it is difficult to conceive of these as operating to limit Government action.

The 'sovereign right' of the Crown of control currency and credit is expressly declared in the preamble to the present Act, The general legal relationship between the Bank and Government is defined by way of listing the primary functions of the Bank. The Bank is to:

'give effect to the monetary policy of the Government as communicated in writing to the Bank and to any resolution of Parliament in relation to that monetary policy.'

and

'for the purposes of this Act, the Minister may from time to time communicate to the Bank the monetary policy of the Government.'

The form of the provision therefore indicates that monetary policy may be communicated both by discussions between the Minister of Finance and the Governor, and by exchanges of correspondence between them. Obviously therefore while the Bank is specifically required to give effect of communications in writing it will also as a matter of practice immediately give effect to a communication by oral discussion where this is required, with formal advice from the Minister being received at a later date.

Other sections of the Act provide in theory for a different legal relationship between the Bank and Government. For instance under s 33 the Reserve Bank may initiate a proposal to require the trading banks to hold liquid assets, which then requires the approval of the Minister. On the other hand the new s 8 (3) requires the Bank to regulate and control credit as directed by

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the Minister. (15) The new s 8 (4) obliges the Bank to make loans to the Government on such conditions as the Minister decides from time to time. A new form of Government control of action which might previously have been considered to be within the sphere of the Reserve Bank is contained in s 34 (8) which relates to financial institutions. The executive branch of Government through the medium of the Governor General is empowered to require for instance financial institutions from time to time to hold balances at the Bank or a trading Bank. (16) On the other hand in respect of similar provisions dating from the earlier Act pertaining to trading banks, (17) the Bank has the initiative.

The contemporary law of the Reserve Bank thus indicates that the subordination of the Bank to Government decision has found statutory definition although in a variety of ways, some of which in view of the aim of the new legislation are obviously anomalous. To a large extent however, the new statutory provisions merely formalise a de facto situation, which has evolved by convention, (18) namely that all decisions of substance are a matter for the government. The distinction between the policy role of the Government and the management role of the Bank (in regard to the expansion or restriction of credit) envisaged by the original

(15) The former s 8 (3) of the RB Act 1964 read ' the Bank may on behalf of the Government, regulate and control etc'

(16) The form of this provision in fact is remarkably similar to that enabling fiscal measures to be adopted.

(17) RB Act s 33

(18) This position has been recognized by a senior officer of the Bank see R.S. Deane, The Function of the Reserve Bank, RBNZ Bulletin September 1972, at p. 215.

draftsmen has therefore been largely lost. The importance of the Bank now lies in its function of advising the Government.⁽¹⁹⁾

The most important functions undertaken by the Bank on behalf of Government, affecting the financing of export trade, lie in the area of monetary policy. Simply stated, the principal objective of monetary policy is to influence spending decisions in the public interest.⁽²⁰⁾ In order to execute this objective, the present Act has armed the Bank with considerable powers, which when invoked, form the basis of particular legal relationships between the Bank, and the financial community. These relate to techniques in common use in central bank practice. Each involves not only the invocation of specific statutory law, but the use of different measures, to ensure its implementation.

The relative effectiveness of the various tools employed in New Zealand to implement the monetary policy of Government has been under active consideration in recent years coinciding with changes in economic thinking, and the growing sophistication and diversity of the New Zealand money market. The merits or demerits of these tools in the New Zealand financial environment, and suggestions for replacement, are discussed elsewhere.⁽²¹⁾ The importance of these techniques for our purposes, is that whatever technique is employed the Government has always ensured that the export sector is directly affected, as little as possible, when they are used to tighten internal credit conditions. They are also important for the reason that the export sector receives the benefit of the subsequent improvement in domestic economic conditions.

(20) "Monetary policy is mainly concerned with influencing the private sector's spending power, by varying the amount which the Government, including the Reserve Bank, borrows from the private sector, and by varying the cost of borrowing, the cost of selling or redeeming a financial asset in order to spend on goods and services." Address by the Chief Governor to Economic Society, Wellington, 12th May, 1977, printed in BNZ Bulletin, July, 1977.

(19) RB Amendment Act s 8 (1) (c).

Particularly on the introduction of the reserve assets ratio system.

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B. Legal Relation between the Bank and the New Zealand Financial Community.

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(21) e.g. N.Z. Monetary and Economic Council Monetary Policy and the Financial System Rep.No. 24. Dec.1972.p67-81, and earlier see the Council's Report employed by the Bank, see Address p171. Particularly on the introduction of the reserve assets ratio system.

Before proceeding, it is necessary to understand the general legal framework in which relations are conducted.

The primary law.

The primary law governing the regulation and control of credit and thereby the relationship between the financial community and the Bank is s. 8(3), which states in part:

"The Bank shall, as directed by the Minister, regulate and control on behalf of the Government -

(a) Money, banking; banking transactions, any class of transactions of financial institutions, credit currency, and the borrowing and lending of money.

(b) Rates of interest in respect of such classes of transaction as may from time to time be prescribed. (22)

(22) s.8(3), as substituted by s.5 of the RB Amendment Act 1973. The major distinction between this section, and the former s.8(3), is that it empowers the Bank to regulate credit from all sources, and not just bank credit. The law relating to monetary control of the non banks is not further dealt with in detail, because the principal providers of export finance are the trading banks, and special measures taken by the Government concern only trading banks. Certain of these institutions however, have an increasing role in the provision of export finance, and a brief review of the application of monetary policy towards them, is useful. The inequity of forcing the banks to carry the main burden in times of tight credit, while little monetary constraints were placed on these institutions, was progressively recognized by the Bank and the Government from 1960 onwards. The 1964 Act authorized the Bank to require information of those that carried on as a substantial part of their N.Z. business, the acceptance of deposits or other banking business, the granting of credit, or lending for the financing of industry, trade or commerce. The Bank was also empowered to make recommendations to them. By s.28A, which was inserted by an amending Act in 1970, the Executive branch was empowered to require finance companies to hold specified investments, as defined in regulations under that section. The new s.34(c) in the principal Act enables orders in Council to be made requiring all financial institutions (other than trading banks), to hold assets of a minimum amount, in the form of balances, at a trading bank, or with the Reserve Bank, Government or local securities, or other assets specified in the order. Under s.8 1(b), it is also a primary function of the Bank to ensure that the availability and conditions of credit provided by financial institutions, are not inconsistent with the sovereign right of the Crown to control credit in the public interest. Thus they are now accorded the importance appropriate to their influence.

The special powers to introduce a number of techniques for this purpose, are contained in Part V of the principal Act. The following may be introduced; variable reserve ratios, selective control of advances (frequently referred to as advance control policy), and a reserve assets ratio system. These techniques have been introduced to operate individually, or in association with, or complementary to other techniques.

(a) Variable Reserve Ratios.

The basic purpose of this technique is to control the quantity of credit. This is effected by immobilising part of the cash⁽²³⁾ of the banks, and leaving varying free margins, increasing the margin of free cash, in order to create tight money conditions.⁽²⁴⁾ An increase in the ratio reduces the cash balances, which remain as a base for lending, and in times of stringent restraint, the ratios may be increased to a level which forces the trading banks to borrow from the Reserve Bank, the lender of last resort, in order to comply with the minimum required holdings. To reinforce this measure, the Bank may resort to the supplementary power of increasing the discount rate on borrowing by the banks.

Under the 1933 Act, the trading banks were required to maintain balances in the Reserve Bank. The minimum balance required⁽²⁵⁾ was 7 per-cent of demand liabilities, plus 3 per-cent of

(23) Comprising holdings of coin, notes and credit balances at the Reserve Bank.

(24) Money and Banking in New Zealand, RBNZ pub. Wellington, 1963, at p102. The original purpose of fixed reserve requirements was to protect bank's depositors, in the light of the ability of the banking system to expend its lending to many times the level of cash reserve. It was only later, that variation of the reserve requirement could be used as a control over bank advances. Hawke.Op Cit p152.

(25) RBNZ Act 1933, s.45.

time liabilities, but the Governor of the Bank was later granted the power after obtaining the consent of the Minister of Finance, to vary these reserve ratios, although not to a level less than the respective minimum balances. (26) The power to vary the ratio, however, was not used until 1952, when bank advances increased markedly, as a result of the boom in wool prices associated with the Korean war.

A new approach to credit control was taken by the Bank in 1956 involving the power to vary the reserve ratios, as an enforcement measure. The Bank established targets for the aggregate amounts permitted to be advanced by the trading banks on a monthly basis. (27) These were enforced by adjusting the minimum reserve requirements in order to "force the banks to borrow at the Reserve Bank amounts equal to the excess" (28)

The 1964 Act removed the minimum reserve requirements, and permitted the Bank, subject to Ministerial approval, complete flexibility in applying the reserve ratios. (29) Whenever the Bank establishes new ratios, notice is to be given in writing to all the trading banks a copy of which is required to be published in the New Zealand Gazette. (30) The penalties for failing to comply, are graduated in severity in accordance with the circumstances surrounding the failure of the trading bank concerned. The Reserve Bank has the discretion to issue a further direction to an offending bank. If such a notice is served on the trading bank, it is unlawful for the bank to continue granting

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- (26) Ibid s.45(2). The power of variation was added by s.23 of the RBNZ Amendment Act, 1926. The power, however, was not exercised until 1952.
- (27) The Bank had no specific regulatory power to give directions concerning the aggregate amounts of advances the trading banks were to hold. The specific power was, however, granted to the Bank by s45 A, RBNZ Amendment Act, 1960.
- (28) Holmes, Op Cit, at p92.
- (29) RB Act 1964, s.33.
- (30) RB Act s.32 (1) and (5). The form of the earlier provision differed slightly, in that only notice in the Gazette was required.

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Credit. Wilful failure on the other hand, to comply with the minimum reserve requirements, is an offence involving fines for each day that the offence continues. (31)

The target system for trading bank advances, however, remained the dominant method of controlling the level of credit, after the passage of the Act. It was also employed as the main technique in encouraging the trading banks to invest in the export sector. (32) This was achieved by the progressive exclusion from the targets of advances to the export sector. The first beneficiaries of this approach were wool brokers, and stock and station agents. In 1965, the Bank advised the trading banks that the targets were to be divided into two tiers. Credit control was concentrated on advances for purposes other than agricultural, and other export production. The two tier approach existed in the same form until 1969 (33)

As a result of the Government decision in 1969, the reserve ratios were frozen at 8 per-cent of demand deposits, and three per-cent of time deposits. Under the ceilings system, the sector eligible for priority advances comprised all farmers, all stock and station agents, meat and freezing companies, wool buyers and special export finance for manufacturers. The lower priority category of advances comprised those to retailers, wholesalers, local bodies,

(31) cf RB Act 1933, s.45(4).

(32) Special export finance has, however been made available using the reserve ratio technique. In 1963, a special export finance arrangement was introduced, under which term loans are made by banks from a fund established at the Bank, equal to 1 per-cent of demand liabilities, which is provided from a special release of the Trading Banks balances, frozen at the Reserve Bank. Another 0.5 per-cent is provided for financing export promotion. Statement of the Minister of Finance, 20 December, 1963, printed in RBNZ Bulletin, June 1963.

(33) The ceiling penalty system adopted as a result of the 1969 budget, is reviewed in RBNZ Bulletin, Sept. 1972, at p218.

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most manufacturers, building firms and private individuals. If the ceilings were exceeded, the trading banks were penalized, unless the excess was due to an acceptable expansion in the export sector. Thus the export sector was for all practical purposes,⁽³⁴⁾ unrestricted. The technique of setting individual bank ceilings, was, however, suspended in 1972. The banks operated instead, under an overall guideline policy for advances. If trading bank advances were reduced to a level acceptable to the Government, an adjustment was made to eliminate the penal borrowing. The rapid increase in export marketing advances up to 1972, had, however, caused concern to the Bank, and as a consequence, the guideline notice also included guidelines for export advances. This allowed for normal seasonal requirements, and for an increase related to the expected rise in farm production and exports. The notice requested the banks to scrutinise closely, the level of their advances for export marketing, and to ensure that any excess over the guidelines was required to finance only the working capital of the industries concerned.⁽³⁵⁾

(b) Selective Advance Control.

The earliest technique of credit control of relevance to the export sector was that of selective advance control. The usual aim of this technique is to ensure that trading banks observe certain priorities, in lending in times of credit restraint. In other words, it is used to restrict the areas in which trading bank advances are to be granted. The statutory authority expressly empowering the Bank to use this technique, is found in s.34 1(b)

(34) The banks were given the right to take up Government securities to the extent that their cash exceeded the "normal minimum" reserve ratios, of 8 per-cent of demand deposits, and 3 per-cent of time deposits. In effect, therefore, individual banks were given what amounts to monthly ceilings for non-priority advances. The penalties imposed for non-compliance with these ceilings, were then distributed among the banks, according to a formula agreed upon between the trading banks, and the Reserve Bank. Each bank was required to borrow for 1 month from the Bank, the amount by which its non-priority lending was charged for this borrowing, on the basis of a sliding scale of penal borrowing rates. Ibid.

(35) The question of a penalty on the top tier was also examined RBNZ Annual Report, 1971, Appendices Journal H.O.R. B.16.

of the principal Act. The Bank is permitted, where it is satisfied that it is necessary or expedient, and in the interest of the public, to direct the trading banks as to the policy to be followed, in respect of;

"The classes of advances and discounts that should be encouraged, or restricted, or refused, and the classes of investments that may or may not be made or held".

The Bank first employed the technique in 1943, when it was introduced by agreement between the Government, the Bank, and the trading banks. ⁽³⁶⁾ Contrary to normal practice, however, it was used in the early years of the bank, to restrict the quantity of bank credit. Selective advance control was in fact the predominate technique affecting the export section, in the years up to 1963. It was applied by the Bank, with varying degrees of stringency during the 1950s, but the general practice was as follows. Advances for certain purposes were prohibited, ⁽³⁷⁾ (subject to reference to the Reserve Bank in doubtful cases). The banks were also allocated a maximum discretionary amount for certain other classes of advances, in order to introduce some flexibility into the system. The Bank, however, was prepared to consider marginal cases on their merits. A prerequisite to reference to the Bank, was that the advance met normal lending principles, whereas, when the case was referred, the name of the applicant was not revealed. Depending on the state of the balance of payments position, the discretionary limits were lifted, or re-imposed. ⁽³⁸⁾ At all times,

(36) The 1933 Act contained no express power enabling this technique to be employed, but although advance control policy was originally introduced by agreement, the power to enforce the requirement clearly fell within the ambit of the Finance Emergency Regulations No 2, 1945. see Hawke. Op Cit. at p142. cf. T.N. Bright, Banking Law and Practice in New Zealand, Sweet & Maxwell, 1962, at p21. This writer implies that the directions before 1960 concerning advance control policy were based on "moral suasion". The express power to issue directions concerning the advance control policy, was accorded to the Bank in 1950 by s.45(A) inserted by the Reserve Bank Amendment Act, 1960.

(37) Commonly restricted, were advances for speculative purposes, purchases of property, repayment of mortgages, for hire-purchase and credit sales and advances for luxury purposes.

(38) RBNZ Pub. Money and Banking, Op Cit.

however, the trading banks were required to give the highest priority "to financing the production of goods for export; to primary production, and to industries using a high proportion of locally produced raw materials, and to essential services" (39)

While selective advance control is no longer a significant element in Government monetary policy, (40) certain features of the enforcement of the policy, contained in the present Act, are of interest. Unlike the enforcement of the minimum balances requirement, failure by the Bank to comply with the direction of the Bank, did not invalidate any transaction between the trading bank and its customer, which does not qualify under the control policy (41) Similarly, the fact that the advance does not qualify under the direction, does not mean the transaction is unenforceable. Instead, the inducement to comply rests solely on a system of fines which are automatically imposed for each day that the offence continues.

(c) Reserve assets ratio system.

The 1964 Act completely recast Part V of the Act, (42) according to the Bank, under s.33, the additional power to introduce a reserve assets ratio system, with the approval of the Minister of Finance. This system was introduced on 1 June, 1973, and its

(39) See e.g. RBNZ Press Release, RBNZ Bulletin, 1963-4

(40) In 1963, the detailed instructions issued by the Bank concerned with advance control policy were withdrawn, and it was no longer necessary for the banks to obtain formal Reserve Bank approval, for the various restricted categories of advances. Instead, broad guidelines were laid down which reiterated the principles established earlier.

(41) s.34(b). Nothing in this section shall affect the validity or enforceability, as between any trading bank, and any other person, of any transaction.

(42) RBNZ Bulletin, November, 1964, at p151.

importance to financing for export, requires a brief review of its operation.⁽⁴³⁾ Section 33 enables the Bank to require trading banks to hold assets of a specified kind, including balances at the Bank.⁽⁴⁴⁾ Minimum requirements may be laid down as a percentage of all or any specified part or parts of a trading bank's assets, in respect of its New Zealand business.⁽⁴⁵⁾ In essence, the reserve assets ratio system consists of a conventional liquidity requirement, with the minimum expressed as percentages of trading bank demand, and time deposit liabilities.⁽⁴⁶⁾ The percentages may be varied by the Bank with the approval of the Minister of Finance. The differential ratios have the effect of allowing the banking system as a whole, to increase advances, by a proportion of the amount of demand deposits, converted to time deposits. Similar to the reserve ratio system, the assets ratios may be varied to expand or curtail spending in the private sector. On the other hand, the ratios may be varied as a technical measure to take account of seasonal and random fluctuations, in the level of reserve assets.⁽⁴⁷⁾ These variations are intended to take account of random fluctuations such as an increase in bank lending to finance an increase in export stocks, resulting from shipping delays, or the current income stabilisation scheme, for sheep farmers.⁽⁴⁸⁾

The new system is designed to allow the banks more scope for flexible lending policies, and to make them more responsible for their own liquidity management.⁽⁴⁹⁾ However, while the top tier priority policy has been abolished, along with the ceiling-on-advances policy, the intention is that the power under s.34 of the Act, will be exercised by the Bank to direct the trading banks to give priority to farmers, and to exporters.⁽⁵⁰⁾ The measures of enforcement are the same as those laid down to ensure compliance with the variable reserve ratios, under s.33.

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- (43) Press statement by the Minister of Finance, 28 May, 1973, "The Evening Post", Wellington.
 (44) s.33, (1) (b).
 (45) s.33, (2) (b).
 (46) RBNZ Bulletin, July 1973, p172.
 (47) Ibid. at p172.
 (48) Ibid. at p173.
 (49) Statement by the Minister of Finance, Op Cit, footnote 43.
 (50) Ibid.

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10. Banker to the Statutory Marketing Authorities

Several marketing organisations whose operations are controlled by statute conduct their banking operations through the Reserve Bank. A statutory obligation is incumbent on the Dairy Board, (51) the Apple and Pear Marketing Board (52) and the Honey Marketing Authority, (53) to do so, whereas those marketing eggs (54) and citrus fruits, (55) are permitted to establish their accounts either at the Reserve Bank or the Bank of New Zealand. (56) Each of these organisations was set up as a consequence of the policy of guaranteed prices for farm produce adopted by the first Labour Government of 1936. A change in the Reserve Bank Act 1933 specifically empowering the Bank to grant overdrafts for marketing purposes

(51) Dairy Board Act 1961, Reprint 1967. s32 under which the Dairy Board is to establish the Dairy Industry Account the Dairy Industry Reserve Account, the Dairy Industry Capital Account. The operation of these accounts is prescribed in s33.

(52) Apple and Pear Marketing Act 1969 s29.

(53) Honey Marketing Regulations S.R.1964/160 s29 (1).

(54) Egg Marketing Authority Regulations 1953 Reprint S.R. 1967/229 s69 (1) (Poultry Industry Account).

(55) Citrus Marketing Authority Regulations S.R. 1966/64 s 20.

These latter three authorities have been established pursuant to the Primary Produce Marketing Act 1953.s.3.

(56) Other accounts held by the Reserve Bank concerning primary production and marketing include the Dairy Industry Produce Development Account, the Milk Industry Account, the New Zealand Wool Promotion Account, the Meat Industry Account and various marketing imprest accounts. The Meat Industry Account is administered by the Department of Agriculture and the funds in this account are part of the primary industry reserves. The bulk of advances under these accounts normally comprise amounts to finance stocks of dairy produce held the Dairy Board. RBNZ Bulletin Dec. p. 292, 293.

each of these authorities and the Bank.
 was made by the Reserve Bank Amendment Act 1936. This clause was repealed by the present Act along with others granting special powers, the situation now being covered by a general empowering clause which is limited by a new section setting out specified restrictions on the Bank's powers. (57) During its history the Bank has also acted as banker in respect of wool and meat marketing as a consequence of the bulk purchase arrangements for meat, wool and dairy produce which were renegotiated between the New Zealand and United Kingdom Governments each year during the Second World War and for some years afterwards. (58) The provision of finance in respect of meat and wool marketing however was handed back to the trading banks upon the resumption of private trading for these commodities in 1954 and 1947 respectively. (59) Of the present marketing authorities only the Dairy Board, the Apple and Pear Marketing Board, and the Honey Marketing Authority are engaged in export marketing. For these reasons this section is mainly confined to discussing the banker/customer relationships enjoyed by

(57) s 10 Reserve Bank Act 1964.

(58) For details of the Bulk Purchase Arrangements see J.V.T. Banker, War Economy. A History of New Zealand in the Second World War Vol. 1 1963 at p. 47.

(59) Certain accounts have been held since at the Reserve Bank in respect of these commodities notably the wool Commission Account arising from the collapse of wool prices in the 1966 - 67 season. See Hawke op. cit. at p. 89. The meat industry account is administered by the Department of Agriculture.

each of these authorities and the Bank.

The relationships between the Bank and the Dairy Board and the Apple and Pear Marketing Board are remarkable in terms of normal banking practice. First the operation of their accounts and the actions of the respective parties to them are prescribed in detail by statute. Secondly, in certain situations, the respective statutes prescribe for the entry of a third party, the Government, into the relationship, thirdly, their accounts are operated in such a way that they depart from the standard principles of bank lending.

The operation of the marketing accounts may best be illustrated by situation regarding the Dairy Board. When the Dairy Board pays the dairy companies for produce acquired for export it must draw on the Dairy Industry Account, ⁽⁶⁰⁾, the proceeds from its purchase being credited to the trading bank accounts of the various dairy co-operatives. The proceeds of the sale of produce overseas enter its overseas Reserve Bank account, for instance at the Bank of England, while the Bank credits the Dairy Industry Account in Wellington. During the time elapsing between purchase and sale, accommodation by way of overdraft may be granted by the Bank in aid of the Dairy Industry account, ⁽⁶¹⁾. A prima facie limit however, is prescribed by statute on the extent to which the account may be overdrawn. The overdraft is not to exceed in amount the

(60) s 33 Dairy Board Act 1961.

(61) Ibid s 33 (3) similarly s 32 (1) Apple and Pear Marketing Act.

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total purchase price of product acquired by the Board and which is either considered or in respect of which no part of the selling price has been received, together with an amount representing other expenses paid in connection with the product such as freight, storage, insurance, advertising and administration salaries. (62)

Unsecured lending by the Bank (in effect an advance on the basis described above is unsecured) is not permitted under the Reserve Bank Act without the prior consent of the Minister. (63) This conflict however, is expressly recognised in the Apple and Pear Marketing Act, (64) thus the accommodation so granted is deemed for the purpose of the Reserve Bank Act not to be 'lending without security.' The situation as regards the Dairy Board is less clear because of an anomaly in the Act but in practice it is submitted the same course would be followed. (65)

(62) The Reserve Bank is entitled to accept a certificate in writing presented by duly authorised officers of the Board which is to be inclusive evidence of the value of the prescribed component items. s 33 (3) . A similar practice is provided for in the Pear Marketing Act: 32 (1).

(63) s 9 1 (d) Reserve Bank Act 1964.

(64) The Apple and Pear Marketing Act s 32 (2) *situation and it is likely the clause*

(65) The corresponding provision s 33. 4 of the Dairy Board Act 1961 which appears in the 1967 Reprint relates to s 14 (d) of the 1933 Reserve Bank Act which expressly prohibited the Bank from making unsecured loans or advances except with the authority of the Governor General. A curious note to this clause appearing in the 1967 Reprint of the Dairy Board Act 1961 to the effect that 'there is no provision in s 10 (i.e. the new s 14) dealing with unsecured loans, does not clarify the situation. A strict reading of s 33 (4) would lead to the result that the consent of the Minister would be required before the Dairy Board could go into overdraft. This however, would be an intolerable situation and it is likely that the clause is read by the Bank and the Dairy Board as now applying to s 9 (1) of the Reserve Bank Act 1964.

The overdraft limit may however be extended with the consent of the Minister of Finance in writing. There is no limit prescribed as to the extent to which accommodation may be granted by the Bank. In practice this is a matter for political decision. The Bank nevertheless is not expected to carry the burden of a decision by the Government to permit an extension of the limit to a point which the Bank considers would not be prudent. The Minister of Finance in this situation or in any case where his consent is required otherwise may give such guarantees to the Bank in respect of the advances to either the Dairy Board or the Apple and Pear Board as he thinks fit. (66)

The rate of interest on advances to most of the marketing authorities has remained at 1 per cent since the commencement of Government marketing department arrangements in the war. It is natural therefore that the facility of a Reserve Bank Account has been utilised by those marketing organisations with an option to use either the Reserve Bank or the bank of New Zealand as their banker. It is also natural that the decision of Government to maintain the rate at this level has been controversial. The main

(66) Dairy Board Act s 38; Apple and Pear Marketing Act. The marketing authorities established by statutory regulation pursuant to the Primary Products Marketing Act 1953 may also obtain a guarantee or indemnity from the Minister of Finance. The marketing authorities are not permitted to borrow without the consent in writing of the Minister of Finance (s 10 (3)). Any payments required in respect of the default of the authorities are from the Consolidated Fund. e.g. In May 1963 the Government announced that it was providing assistance to the dairy industry by way of special guarantee of the Boards overdraft at the Reserve Bank in order to provide the necessary resources for establishing milk reconstitution plants in developing countries. The special account established for this purpose bore interest however, at 3 per cent payment of which was deferred during the establishment of the projects. RBNZ Bulletin 1963 p. 154.

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arguments against the low rates, and indeed, the operation of the marketing accounts at the Reserve Bank, rather than at trading banks were expressed in two recommendations of the 1955 Monetary Commission. (67) Despite the controversy and at one stage against the recommendation of the Bank itself, (68) successive Governments have been unwilling mainly for political reasons to communicate a change of policy to the Bank to this effect, although variations in the rates differ. In fact it has also been argued, that there may be sound economic reasons for not doing so. (69)

In any event the establishment of the accounts and their operation evidence the importance that the state has always placed on

(67) The 1955 Monetary Commission while considering that the Dairy Account by virtue of its size should remain at the Bank considered that 'in general we think it undesirable that the Reserve Bank should finance commercial transactions of this kind and would recommend that steps be taken to transfer the accounts of the other marketing authorities to the trading banks'... and that 'there is no reason why statutory marketing authorities by virtue of the fact that their accounts are held at the Reserve Bank should receive preferential treatment in respect to interest charges.' It concluded that 'the rate of interest payable on an advance granted by the Reserve Bank to a statutory body should be similar to that which it would be required to pay if its finance was obtained from the trading banks. Report of the Royal Commission on Monetary Banking and Credit Systems 1956 Govt. Printer para 611 and 612.

(68) Hawke op cit p. 87.

(69) Ibid pp 88-89.

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the economic welfare of those farm industries which earn the bulk of New Zealand's overseas exchange. (70) That the operation of the accounts depart from fundamental principles of bank lending in respect of security and profitability has never been considered by Governments as important. Instead the operation of the accounts particularly the Dairy Industry Account at the Reserve Bank and the statutory powers enjoyed by the Minister of Finance have enabled the State to intervene readily and on a flexible basis to ensure that the provision of credit facilities is not impeded. In this way the statutory marketing legislation provides perhaps the best example of the employment by the State of a number of techniques of law to influence export financing.

(70) The fundamental principle of trading bank lending was stated by the Associated Banks in New Zealand (now the NZ Bankers Association) in evidence to the 1955 Monetary Commission to be 'to confine advances as far as possible to financing customers current trade or seasonal requirements and to avoid tying up available resources infixed or long term finance . The factors to which main importance is attached are, (1) the purpose of the advance and the nature of the business, (2) the source from which repayment is expected to be made, (3) the character and business capacity of the borrower, (4) the nature and adequacy of the security offered and the financial position of the borrower. An advance may also be declined because the prospects of obtaining with a reasonable time from sources other than a forced realisation do not appear satisfactory.

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C.D. The Bank and Export Credits

1. Background

Export credits take two basic forms namely suppliers credits and buyers credits.⁽⁷¹⁾ Suppliers credits are granted by suppliers to foreign buyers either on a medium term basis or on a long term basis. Since few suppliers selling on deferred payment terms have sufficient resources to bridge the credit period, most of them finance the credits they grant with a credit institution notably a trading bank which generally refinances them under an export credit refinancing scheme with the central Bank or specialised institution. Buyers credits are granted directly to foreign buyers by credit institutions or consortia or credit institutions in countries exporting capital goods to enable them to acquire the needed capital good or services by paying cash to the suppliers, the Governments of the exporting countries guaranteeing repayment under their export credit insurance schemes.

In the export credit situation the only parties involved other than the importer and or bank are the exporter and a government agency. The Government agency actually finances all or a portion of the exports by paying the exporter and taking over the promissory notes or other securities, which evidence the credit

(71) A full description of the various arrangements implied by these terms are set out in National Export Credit Systems 1969. UN pub: Sales No. E. 69 II D 7 Intro.

extended to the importer. The Government agency has direct contractual relations only with the exporter. (72)

Export credits have played a much lesser role in New Zealand's export trade than in the export trade of other developed market economy countries. There are three main reasons.

First New Zealand is fundamentally a capital importing country being in a similar position to many developing countries in terms of capital needs.

Secondly primary products and manufactured consumption goods have traditionally formed the bulk of New Zealand's exports rather than capital goods. Overseas importers of these goods can normally recoup their expenditure quickly, thereby obviating the need for all but short term credit to cover the transitional period.

Thirdly the most of New Zealand's exports are destined for developed market economy countries which do not seek soft credit terms.

For these reasons early action by Government was taken in response to specific request for economic aid. More recently Government has been compelled to look beyond bilateral lines of credit, in order to promote the diversification of both the range of exports of goods and services and markets. The facilities

(72) International Financing and Investment. Export Financing
J.F.McDaniels New York 1964. Part V p. 379.

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sponsored by Government are designed to overcome the lack of well established private institutional facilities for financing longer term export credits. The instrument through which the provision of suppliers credits by the trading banks is encouraged is the Reserve Bank.

2. Long Term Export Credit Arrangements

a) Refinancing by the Bank

The first facility of this type, announced in 1969, enables the Bank to make loans on reasonable terms to New Zealand trading banks to replace funds, ⁽⁷³⁾ which that bank has used to finance exports in terms of over 12 months. The loan must be valued at over \$20,000 and no specific security is required. ⁽⁷⁴⁾ Applications for the loans may be made after the credit has been extended by the trading bank but it is preferred that the application is made prior to the period for which the credit has been given. The Bank gives commitments of rates and amounts before exporters

(73) The original intention of the Bank was to rediscount long term export bills. Discussion with the trading banks however, revealed that rediscounting was an unnecessarily complicated method. The alternative system of making loans as counter-part funds for the credits, the trading banks had extended to their customers was styled on the experience of the Australian Export Refinance Corporation. Annual Report of the Bank 1970. Appendices, Journals H.O.R. 1970. B 16.

(74) The Bank has power to make loans on such security as it requires. Where a loan without security is contemplated the prior consent of the Minister is required. s 9 (8) (d).

(75) Annual Report 1971 1972

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have a firm order. If the exporter fails to obtain the order, the trading bank is requested to cancel the commitment rather than let it lapse.

Unlike rediscounting the Bank incurs no liability for the default of the overseas buyer as the trading bank receiving the loan undertakes in its application to pay the Reserve Bank the specified amount on specified dates.

Since the terms of the credit would normally eventuate in the breach of exchange control regulations, in that the proceeds of specific exports are not received within the statutory six months, the Bank gives approval under the regulations to this requirement being covered. Approval, however is conditional on the Bank being satisfied that the extended credit is normal in the particular trade or that in a specific instance it is necessary in order to make the sale.

b) Rediscounting by the Bank

1 December 1971 an extension to this facility was announced (75) involving different legal relationships for the Bank. Under the new arrangement the Banker is prepared to rediscount bills without recourse under a line of credit available through the trading banks to finance export supplies credits. The facility is generally only available where a sale would be likely to lead to the development of further trade. (76) It is also intended to

(75) Annual Report RBNZ 1972

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cover those cases where suppliers credits must be for longer or softer terms than usual and which may incorporate grace periods during which there are no payments of interest or repayment.

The scheme takes the form of a revolving credit of \$2 million established by the Bank. Exporters with specific proposals apply in advance through their trading banks to the Bank. Since the Bank is not in a position to establish the credit worthiness of individual importers a number of safeguards are built into the scheme to protect the Bank. To discourage exporters from concluding contracts without due regard for the credit worthiness of the purchaser, the Bank requires that either a stipulated proportion of the sale price is withheld from the advance or, where appropriate, the exporter is held liable for default up to the amount that ^{??} otherwise have been withheld.

In addition the Bank requires an acceptable irrevocable letter of credit or other instruments to be established by the importer's bankers which provides for the meeting of bills drawn by the exporter and incorporating certain terms. (77) The Bank is also

(76) The New Zealand content of the proposed exports is expected to be the maximum possible, but in considering individual cases this factor is weighed against profitability.

(77) The terms are as follows

- i) Interest at a rate which is decided in the light of circumstances at the time of the application.
- ii) The first bill normally to mature no later than two years after shipment, or completion of the contract.
- iii) The remaining bills to mature at regular intervals and repayment to be completed normally no later than 5 years after shipment or completion of the contract.
- iv) The arrangement to be expressed and payable in \$US, sterling, or some other convertible currency (the actual currency is decided at the time of application).

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also requires the exporter to take out cover, with the Export Guarantee Office.

3. Trade Aid Credits

Since 1947, a number of Government bilateral credit agreements have been concluded by New Zealand with other countries, to enable the latter to purchase New Zealand products. (78) Each of these instruments was executed to meet a specific aid or economic development situation. (79) At the same time, each was concluded with a view to advancing New Zealand's trade interests, although in some agreements, the element of New Zealand's trade was more important than in others. (30) Only two credits involved New Zealand goods other than major primary commodities, but in practice, traders of primary products have been the main beneficiaries (81) under the schemes.

To enable the Government to conclude the first loan agreement with France in 1947, using the medium of the Reserve Bank, the 1933 Act was amended. (82) The Bank was thenceforth empowered to "advance

(78) Agreement between the Government of France and N.Z. for the purchase of N.Z. wool, 2 July, 1947, 1948 Appendices to the Journals of the House of Reps., Vol.I A.9; Agreement between the Governments of Czechoslovakia and N.Z., regarding the purchase of NZ wool, 22 January, 1948, 1948 A.J.HOR A.10; Agreement between the Governments of NZ and India, regarding the purchase of wool, 22 February, 1963, 1963 A.J. HOR A.10; Agreement between the Governments of NZ and Peru, concerning the purchase of NZ dairy products. 3 December, 1969, 1970 A.J. HOR Vol I, A.20; Agreement between the Governments of NZ and Indonesia, 1970, A.J.HOR Vol I, A.21, renewed 1971, 1972, 1973.

(79) e.g. the Indonesian credit originated as part of an international balance of payments rescue operation. Similarly, the French credit was part of the post-war reconstruction programme in Europe.

(80) e.g. the Peruvian credit was offered primarily in order to enable the Dairy Board to secure its established share of the market that was being threatened by concessional sales from the EEC. Annual Report, Department of Trade and Industry.

(81) The French credit was predominantly used for wool exports. The major beneficiaries under the Indonesian credit have been the Dairy Board, and the pulp and paper producers.

(82) Finance Act (No.2) 1946 s.4

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monies to the Government of any country in respect of any New Zealand produce for export to that country, or guarantee any such advance that may be made by any other bank" Transactions for this purpose were required to be approved by the Minister of Finance, and moreover, the amount involved was not to exceed a ceiling of 10 million pounds.

Neither the ceiling of lending, nor the "tied loan" prescription appear in the present Act. ⁽⁸³⁾ The present provision also differs in that the power to grant loans to other Governments is implicit in the powers conferred on the Bank under s.9 (1). For this reason, the present section acts to limit these broader powers by the requirements that the Minister of Finance must approve such loans. The amount of any loss by the Bank in respect of any loan, advance, credit or guarantee for this purpose, is paid to the Bank out of the public account.

The form of the more recent agreements substantially follows that of earlier credit agreements with France, Czechoslovakia and India. ⁽⁸⁴⁾ The New Zealand Government extended the credit to the recipient government, in return for which, the recipient agreed to apply the credit solely to purchases of New Zealand origin. ⁽⁸⁵⁾ Associated with the Peruvian Agreement was a five year commercial agreement between the NZ Dairy Board, and the Peruvian Government purchasing agency, EPSAP, which agreed to purchase not less than 63 per cent of its annual requirements of skim milk powder and anhydrous milk fat from the Dairy Board. Thus the Government of Peru also guaranteed to purchase no lesser quantity than was provided in the commercial agreement. If this obligation was not complied with, the total amount of loan moneys

(83) s.11 RB Act 1964.

(84) The Indonesian Credit 1973 is the only agreement presently in force. The Peruvian Credit expired in October 1971, and all purchases are now being made on commercial terms.

(85) Peruvian Agreement Act 1 (1); Indonesian Credit Act 1 (1).

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and interest owed by the Government of Peru became immediately repayable.

The Indonesian Credit agreement differs in that the Indonesian Government determines the commodities eligible for credit financing. (86) The advantage of the credit for the importer is that he may purchase funds at a lower rate of exchange than that applying to normal exchange transactions.

Drawings under each agreement have been administered by the respective central banks, the procedures in respect of which, vary in complexity with the nature of the trade, in the commodity contemplated under the Agreement, or in the case of the Indonesian agreement, that which the central banks decide. An account has been generally opened with the Reserve Bank, which records all the operations in connection with the credit, (87) details concerning which, are normally provided in a protocol of signature attached to the agreement.

The technique of providing export credits through bilateral inter-governmental agreement is well established overseas. Unlike the special export credit facilities provided by the Bank, however, the technique is inflexible, and often requires time consuming negotiation. An added disadvantage for New Zealand, is the aid element which is incorporated into the agreements. This makes such agreements difficult for any capital importing country, to sustain for prolonged periods. For these reasons, New Zealand has not been prepared to enter readily into long term commitments of this nature. The New Zealand agreements have also been used almost entirely for agricultural products, thus subsidising products of the least importance in the diversification of the New Zealand economy.

(86) Imports are classified according to their essentiality. For its part, the NZ Government has stipulated that only goods with a 60 per cent NZ content (in terms of f.o.b. price) qualify for export under the credit.

(87) The accounts have generally been expressed in U.S. dollars, or Sterling.

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Conclusion

The law and practice of State intervention in the field of financing New Zealand's export trade, has been derived from two major sources. Whatever techniques have been employed to implement the monetary policies of Government, finance for the export sector (although this term was formerly thought to be synonymous with the agricultural sector) has received first priority. The second source is the law and practice of existing institutions, and those new institutions established to meet demands which had been created by the diversification policies of recent Governments.

Existing institutions have been adapted, and re-orientated. The Reserve Bank has assumed a promotional role, as a financier of the export trade, in its own right. The DFC is being granted a more prominent position in the financial system, namely, as the Country's development bank, with attributes similar to those of its counterparts in developing countries.

The practice of these institutions, departs in fundamental ways, from the traditional practice of private sector institutions. The difference in practice is largely explained by the fact that New Zealand inherited private institutions, modelled on parents whose characteristics were not appropriate to the needs of a developing country. As the demands for export orientated development finance grow, it must be expected that statutory prescription will correct any inability on the part of the private financial community, to adapt to this environment.

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