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# Report on the Establishment of a Central Bank for Ceylon

**NOVEMBER, 1949**

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## LETTER OF SUBMITTAL

The Honourable MINISTER OF FINANCE,

IN July, 1948, the Government of Ceylon transmitted a request to the Government of the United States through the American Embassy at Colombo asking for the services of an official of the Federal Reserve System to advise upon the establishment of a Reserve Bank for Ceylon. As a result of subsequent negotiations you accepted on November 25th the offer of the Board of Governors of the Federal Reserve System to lend my services for an initial period of six months. I arrived in Colombo, on December 28th and took up my task shortly after the beginning of the new year. At the request of the Government of Ceylon the Board of Governors has since agreed to two extensions of the period of my services.

2. Upon my arrival in Ceylon you directed your Permanent Secretary to request me—

“(a) to report on the organisation and the functions of a Reserve Bank for Ceylon with a view to ensuring, within the limits of monetary action, full employment of the economic resources of the country, and, if need be, on the promotion of supplemental credit institutions in furtherance of this policy ; and

(b) to frame proposals for a draft constitution of the Reserve Bank for Ceylon ”.

You also made the services of Mr. N. U. Jayawardena, Controller of Exchange, available to me in a consultative capacity, and Mr. D. C. Gunasekera, Senior Assistant Controller of Exchange, was assigned as my Secretary.

3. On and after the 5th January of this year we placed a series of advertisements in the Sinhalese, Tamil and English press citing the above terms of reference, inviting any person desiring to give evidence to send in his views in the form of a memorandum and stating that where necessary personal interviews would then be arranged. Owing undoubtedly to the technical nature of the subject the response was small.

4. On 7th June, 1949, you received my interim report making certain specific preliminary recommendations in regard to the monetary system, the organization of the Central Bank, guiding principles of monetary administration, and instruments of Central Bank action.

5. In compliance with request (b) of paragraph 2 above and on the basis of the recommendations in the interim report, I then proceeded with draft legislation for the establishment of a new monetary system for Ceylon and a Central Bank to administer and regulate the system. It was drafted and revised in continuous consultation with Mr. H. N. G. Fernando, the Legal Draftsman. The draft bill was first submitted to you on 6th October and you presented it to the House of Representatives on 26th October.

6. The report requested in (a) of paragraph 2 is submitted to you herewith. It consists of two parts. The first is intended to give some indication of the significance of the introduction of a central banking system into the Ceylon economy. The second contains the draft bill with interspersed comments which are intended to explain the reasons for recommending the particular form of Central Bank to be established by the Bill, the considerations underlying the more important of its clauses, and the meaning of some of the more technical clauses which might not be readily intelligible to the lay reader.

7. I have gathered sufficient material, in addition, for a further report, which would summarize the principal factors affecting the monetary policy of Ceylon today and the role that a Central Bank of the type that I have suggested may be expected to play in the economy of this country. It would include comment on such topics as Ceylon's balance of payments and international financial position, the sterling balances, exchange control, import and export control, devaluation, inflation, Government fiscal policy, the capital market, national development, and the role of supplementary credit institutions.

4th November, 1949.

JOHN EXTER.



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# REPORT ON THE ESTABLISHMENT OF A CENTRAL BANK FOR CEYLON

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## PART I.—THE SIGNIFICANCE OF A CENTRAL BANKING SYSTEM FOR CEYLON

THE decision of the Government of Ceylon to establish a central bank was a decision with far reaching implications for the people of Ceylon. One implication already stands out very clearly ; in taking steps to establish an independent monetary system to be administered by a central bank the Government has demonstrated unmistakably its intention to achieve genuine economic freedom as a corollary of the political freedom achieved a year and a half ago. It has been the endeavour of this report to propose a type of central bank which, with proper skill and understanding in its management, will establish monetary conditions in Ceylon that may make possible, as never before, the fuller use of the nation's human and material resources and a rising standard of comfort for all.

The importance of money and credit in a modern economic system hardly needs to be argued. Perhaps no single factor can do more to influence the welfare and growth of a community than the flow of money. It is the mechanism by which the resources of a country can be mobilised for production. It plays a dominant role in the determination of prices and wages, of income and employment. Stable money is essential to performance under contracts and to the equitable liquidation of debt ; it is the life-blood of foreign trade.

A central bank thus undertakes a great responsibility, and the broad powers given to the Central Bank of Ceylon under the draft bill in Part II of this report are commensurate with the magnitude of this responsibility. The Bank should not be hampered by rigid limitations which might prevent it from fulfilling its purpose. When a new central bank is being established it is impossible to predict the course of its development. This will depend upon the environment within which it works and upon those who determine its policies. Many of its powers may go unused for long periods, because they are designed for particular situations, some of which may never arise. Others are intended for use only in crises or to forestall a crisis, but prudence dictates that they be included now, so that they will be at hand in case of need. It would be foolhardy to assume, with the record of the war—and depression—induced economic crises of the last 30 years plainly before us, that the Ceylon economy will somehow escape such crises in the future. The safer assumption is the one underlying the drafting of the present bill ; it is better in an uncertain economic world to be prepared for any eventuality.

Many features of the draft bill have been developed in the Western Hemisphere. Others are found in one form or another in central banking legislation within the Commonwealth. The basic pattern is suited for countries which are introducing central banking systems for the first time because it contains certain signposts and warning signals which should prove useful to administrators who do not have long established traditions and years of personal experience upon which to rely. It also provides a legal structure which is flexible and adaptable to changing economic conditions. Within the structure there is ample room for the development of policies that are appropriate to the times.

Good central banking is less good law than good practice. The Central Bank of Ceylon may make its influence felt more effectively through the development of day-to-day relations of confidence and understanding between itself and the various banking institutions than through the exercise of all of the powers given it under this bill. Such influence is known in the textbooks as " moral suasion " and should be especially important in a small country where it should be possible to develop close relations between the Central Bank and each of the fairly limited number of banking institutions.



### (1) A central bank contrasted with the Board of Commissioners of Currency

A central bank, like the present Board of Commissioners of Currency, is a monetary authority. The powers of the Board, however, are very narrowly limited to the automatic issue of Ceylon rupee notes and coins against an equivalent value of Indian rupees lodged with the Reserve Bank of India, and the converse process of retiring such notes and coins when the Board is asked to pay out Indian rupees from its account with the Reserve Bank of India.\* A central bank ordinarily has similar authority to issue its notes and coins against assets in foreign exchange, but most central banks have far more power in monetary matters than the present Currency Board. For instance, they ordinarily issue currency, and create deposits, against domestic as well as foreign assets. But what is even more significant, they have powers to control the expansion and contraction of credit by the commercial banks. Demand deposits subject to transfer by cheque have in most countries of the world become a more important form of money than actual currency, and variations in the volume of demand deposits resulting from changes in the cash positions or in the credit policies of the commercial banks frequently have more profound economic effects than variations in the supply of actual currency. It has therefore become essential to give central banks considerable control over the credit activities of the commercial banks.

For many central banks the principal basis of such control is the requirement that the commercial banks hold reserves at least equal to a prescribed proportion of their deposit liabilities. Such reserves are ordinarily held in the form of deposits with the Central Bank. Given such a requirement, a Central Bank can influence the credit activities of the commercial banks either by the direct method of raising or lowering the prescribed ratio or by the more indirect method of varying the actual amount of bank reserves by expanding or contracting its own credit. This ability to alter either the required reserve ratios, or the actual reserves, of the commercial banks, together with certain additional controls which it may have over the credit and foreign exchange operations of commercial banks, gives a Central Bank vastly greater power to influence the rôle of money in an economy than the Board of Commissioners of Currency has ever possessed in Ceylon.

### (2) Logical basis of the present monetary system

The proposal to establish in Ceylon a new monetary authority in the form of a Central Bank has necessitated an examination in detail of the logical basis of the present monetary system, particularly the way in which the international value of the rupee has been determined and maintained. The devaluation of sterling area currencies in September sharpened the issues and precipitated a step, the breaking of the currency link with the Indian rupee, which might otherwise have been postponed until the establishment of the Central Bank.

The Ceylon monetary system has long been a hybrid. Until the recent amendment to the Currency Ordinance, the Ceylon rupee was linked at par to one currency, the Indian rupee, while the bulk of the reserves were ordinarily held in another currency, sterling. Although a 100 per cent. reserve system, it has differed from most such systems in that the reserve has been divided between two currencies instead of being held in one. Although the law has provided for an optional exchange of Ceylon rupees for sterling, in practice convertibility has until very recently been maintained solely through the Indian rupee.

As long as the Ceylon authorities could be sure that the Indian rupee would remain stable with respect to sterling and that there would be complete freedom of convertibility between Indian rupees and sterling, there was some logic in the Ceylon system. In practice it worked almost as though the rupee were tied directly to sterling. But in 1946, when India agreed with the International Monetary Fund upon a gold par value for the Indian rupee, the automatic link of the Indian rupee to sterling was broken. Furthermore, in September, 1947, the Indian authorities

\* The Currency Ordinance was amended in 1944 giving the Board the authority to receive or pay sterling through the Crown Agents in London, but this authority was not used until after the recent devaluation and the severing of the link of the Ceylon with the Indian rupee.



instituted exchange control over transactions with other countries within the sterling area. Finally, in June, 1948, Ceylon itself began to control transactions within the area including, paradoxically enough, transactions in the very currency to which the Ceylon rupee was linked. Thus the relationship of the Ceylon rupee to sterling by way of the Indian rupee was broken, and such logic as once existed in the system was destroyed. After Ceylon became politically independent, there was no longer any sound reason for continuing an arrangement whereby the international value of the Ceylon rupee was automatically determined by the Indian authorities.

During the recent devaluation crisis, therefore, it was logical and reasonable that the Ceylon Government should seek to achieve a greater degree of monetary autonomy by redefining the international value of the Ceylon rupee in terms of gold. Ceylon's membership in the sterling area, as well as the importance of sterling as an international currency in general and as the principal currency for financing Ceylon's trade in particular, suggests that the Indian link might have been replaced by a direct sterling link. Although such a link can be more readily justified economically than the Indian link, it does not appear to have any particular merit not possessed by a definition in gold. In fact, whenever a country voluntarily links its currency to another, it establishes a satellite-planet relationship which in effect proclaims that the satellite will always move with the planet. This is tantamount to a renunciation of a basic element of monetary sovereignty. By defining the rupee independently in terms of gold Ceylon asserted the equality of its status with other countries in the Commonwealth and the sterling area, and ensured its participation henceforth in revaluation affairs in the same manner and on the same terms as any other member. The decision as to the value of the country's currency now rests completely with Ceylon.

The decision to use gold as a standard of value for the Ceylon rupee is in accord with modern practice throughout the world. The Articles of Agreement of the International Monetary Fund, to which Ceylon has already applied for membership, require all members to express the par values of their currencies either "in terms of gold as a common denominator or in terms of the United States dollar of the weight and fineness in effect on July 1, 1944". Consequently, assuming that Ceylon will be admitted to the Fund, it would have been necessary in any case to define the rupee in gold.

There is the further consideration that sterling and Indian rupees are no longer freely convertible into gold or into freely convertible currencies. Ceylon's close economic ties with the sterling area and its large holdings of sterling and Indian rupee assets give Ceylon an important stake in the struggle of the United Kingdom to re-establish the free convertibility of sterling for current transactions. This is not a sufficient reason, however, for continuing legislation so restrictive that the monetary authority is actually prohibited from holding assets in any but two sterling currencies. Such a prohibition is particularly irksome at a time when the country is ordinarily earning a net surplus of freely convertible currencies, and when the United Kingdom Government has recognised in principle Ceylon's right to hold an independent hard currency reserve.

Before discussing the fundamental principles on which the Ceylon monetary system ought to be based, it would be well to examine in some detail the origin and operations of the present system.

### (3) Origin and operations of the present monetary system

The present practices of the Ceylon system began to develop as early as 1903, shortly after India adopted a gold exchange standard. Such a standard differs from the pure gold standard (in which gold itself circulates or the note issue is fully backed by gold) only in that the monetary authority holds, instead of gold, a reserve in the foreign exchange of a gold standard country and undertakes to deliver this exchange for its own notes on demand at a fixed rate. In the simplest and most rigid form of the standard the reserve must be 100 per cent. of the note issue, though it need not all be held in liquid foreign exchange, but may be invested in prime securities of the Government of the gold standard country. Of course, when Britain was not itself on the gold standard, this system was, for the countries holding their



reserves in London, a sterling rather than a gold exchange standard. Ceylon's very close economic bonds with India undoubtedly influenced the decision to link the Ceylon rupee to the Indian rupee, rather than to establish a formal exchange standard system based directly on sterling. The Currency Board long followed the practice of issuing and withdrawing notes for Indian rupee coins. When this practice was replaced by the more convenient one of exchanging notes for Indian foreign exchange, the operations of the Ceylon system and its economic effects became very much the same as if Ceylon were on a gold (or sterling) exchange standard directly. Both Ceylon and India of course have always been members of the sterling area.

During the Nineteen Twenties the exchange standard type of monetary system was used by many countries of the world, though the larger countries especially did not use it in its 100 per cent. reserve form. Many countries abandoned the system during the Great Depression, so that its most widespread use during the Nineteen Thirties was within the sterling area. Today the use of the 100 per cent. reserve is limited almost exclusively to the British dependencies.

For the countries that continued to hold their foreign exchange reserves in sterling, the system underwent a fundamental change after 1931, when Britain depreciated the pound, left the gold standard, and adopted a paper standard under which the sterling price of gold was permitted controlled fluctuations; and a still more fundamental change after 1939, when sterling convertibility into gold was suspended altogether.

Under the Ceylon system in which a 100 per cent. reserve is required against the note issue and the use of cheques is not highly developed, the money supply tends to be automatically responsive to surpluses and deficits in the balance of international payments. Whenever Ceylon is acquiring foreign exchange faster than it is utilizing it (*i.e.* when there is a surplus in the balance of payments) the banks purchase Ceylon rupees from the Currency Board with their surplus exchange. The Currency Board pays the banks in rupees by drawing notes from its unissued stocks, and it holds the foreign exchange either in Bombay or in London. (It may, of course, invest a considerable portion of this exchange in Indian or British securities in order to earn a return on the funds.) On the other hand, whenever the country utilises foreign exchange faster than it acquires it (*i.e.*, when there is a deficit in the balance of payments) the banks meet the demand for exchange by purchasing it from the Currency Board with rupees. The Board retires the rupees from circulation and transfers the exchange to the purchasing bank by means of a draft or a telegraphic transfer. The first process increases the currency in circulation by the amount of the surplus, and the second process decreases it by the amount of the deficit.

#### (4) Advantages and disadvantages of the system

This system is simple and easy to operate. As long as economic pressures do not force its modification or abandonment, it assures the international stability of the rupee. Before the days of exchange control it was particularly conducive to foreign investment because investors, especially those within the sterling area, had every assurance that the rupee exchange rate would not be altered in terms of sterling and that there would be no impediments to realizing profits or repatriating capital. This type of system, therefore, has long been a mark of colonialism.

For a developing economy it has a number of serious disadvantages. The role of the Currency Board must remain purely passive; it cannot influence the money supply in any way and thus relieve the pressures to which rapid swings in the balance of payments may at times subject the economy. A 100 per cent. system is thus a "fair-weather" system. Under normal balance of payments conditions it is not likely to break down, but its excessive rigidity may impose undue hardship in periods of economic crisis. Even in normal times it can do nothing to make credit more available to meet the growing needs of an expanding economy; nor can it influence the cost of credit. Under such a system the banks are vulnerable, for without a Central Bank they have nowhere to turn for help in case of need. The system also tends to freeze needlessly a rather large portion of the international reserve. A reserve has to be maintained against even that hard core of notes which is always needed to finance domestic transactions, however adverse the balance of payments conditions.



Finally, such a system may be expected to impart a consistently deflationary bias to a growing economy. As Ceylon's population increases and its domestic trade expands, it will naturally require an ever-increasing money supply. In the absence of a highly developed banking system, under which a significant expansion of bank credit would be possible, an increased money supply can be achieved only through a persistently active balance of payments on current account, or by borrowing abroad without using the proceeds to import goods. An active balance of payments is a costly luxury for an under-developed country, and as for borrowing abroad, it neither makes economic sense to incur foreign indebtedness in order to finance domestic expenditures in a country's own currency, nor is such practice on any significant scale likely to be possible in the present-day world.

Although the International Monetary Fund has tried to foster stable exchanges and sound exchange practices since the war, there is still a great deal of uncertainty in the field of monetary management. The times clearly call for more flexible legislation which will permit the Ceylon monetary authorities to take action, as occasion requires, to protect the country's economic interests.

#### **(5) Recommended changes in the Ceylon Monetary system**

The recommendations which follow have been prepared with the foregoing considerations in mind. Now that the Ceylon rupee is no longer defined in terms of the Indian rupee, there is no need to require that its convertibility be maintained principally by issuing and redeeming Ceylon currency for Indian currency. The monetary authority should be required to buy and sell any quantity of foreign exchange offered or demanded, except that it should not be required to purchase inconvertible currencies unless there is an actual or anticipated demand for such currencies, or unless the monetary authority determines that the acquisition of such currencies is in the national interest.

Nor is it necessary to require the monetary authority to hold its reserves only in Indian rupees or sterling. It should be permitted to hold reserves in any currency it chooses, or in gold, with the special provision that it should endeavour to keep at least a nuclear reserve in gold or in currencies which the authority can freely convert into gold. Instead of requiring a 100 per cent. ratio of the international reserve to the note issue, it is recommended that there be no prescribed fixed ratio, but that the monetary authority maintain a reserve adequate to meet any foreseeable deficits in the balance of payments. Within the limitation on its freedom of action the Central Bank should have the power to vary the money supply with a view to meeting the domestic needs of the economy as well as maintaining the international stability of the rupee.

And in place of the present Board of Commissioners of Currency with narrow and largely automatic powers, there should be established a new monetary authority, a Central Bank having broad powers to administer and regulate the entire money, banking and credit system. The bank should be a banker's bank and as such should not engage in commercial banking, nor have important relations with the public except in the course of its open market operations. It is recommended that it be endowed with a degree of supervisory and administrative authority over the nation's banking and credit system not heretofore possessed by any agency of the Ceylon Government.

#### **(6) The consequences of a central bank for the Ceylon economy**

In addition to changing the whole basis of the relationship of the Ceylon rupee to other currencies in the world, the greatest significance of the introduction of a Central Bank lies in the power of the bank consciously to influence the supply, availability, and cost of money in Ceylon.

This it can do through its ability to engage in lending operations with the banks and the Government and its authority to buy and sell Government securities in the open market. Such operations increase or decrease the money supply in the same



manner as do the Bank's foreign exchange operations. The difference is that the Bank's foreign exchange operations will be compulsory, whereas its domestic credit operations will be discretionary. It will be required, unless it takes the emergency step of suspending payments, to buy and sell foreign exchange in unlimited quantities on the initiative of the commercial banks—just as the Board of Commissioners of Currency must now freely issue and redeem Ceylon rupees for Indian rupees. Such a requirement is necessary in order to maintain the par value and free convertibility of the rupee.

Since the Bank's domestic credit operations will be voluntary, it can regulate them with a view to the credit needs of the domestic economy. For example, if the Central Bank makes an advance to a commercial bank by buying its promissory note, or if it purchases a Government security in the open market, its note and deposit liabilities will increase just as they would increase when it bought foreign exchange. When, on the other hand, the note is repaid or the security is sold, the equivalent liability will be extinguished just as a liability would be extinguished when the Bank sold foreign exchange. These credit operations may take a great variety of forms, as an examination of the accompanying draft law will reveal. Whatever the form, the broad monetary effects will be the same. Any increase in the Bank's credit will tend to expand the money supply ; any decrease will tend to contract it. Thus the Bank will be able to use its domestic credit operations to augment or offset the effects on the economy of its foreign exchange operations.

The establishment of the Central Bank should greatly strengthen the banking system. Through its power to examine and supervise the operations of the commercial banks, it can prevent them from engaging in unsound banking practices and thus protect Ceylon depositors against bank failures. As "lender of last resort", it will stand ready at all times to purchase or make loans against acceptable paper, and thus make the banking system almost invulnerable in time of crisis. It can influence the character of bank operations. It can stimulate the banks to increase their loans, to lend for longer terms, to lower interest rates and to expand their services to the public. By ensuring competition in the field of exchange banking, it can reduce excess profits from exchange transactions, thus providing the banks an incentive to expand their domestic banking business. The Central Bank will also stimulate the growth of indigenous banking by making available to Ceylon banks the Central Bank facilities which are already available to the home offices of foreign banks ; and it will improve the credit standing of Ceylon banks with their foreign correspondents.

The Central Bank can contribute materially to the objective of channelling the savings of the public into worthwhile investments. By strengthening the banking system, it will encourage the public to make greater use of the banks as depositories for their savings, thus enabling the banks to lend to many whom they are now unable to accommodate. The Bank will assist in the development of the broadest possible market for Government securities by providing through judicious market support, the price stability and liquidity that are necessary to attract investment funds.

Finally, the Bank can do a great deal to introduce more effective management of the public debt and more efficient handling of public finances by acting as the Government's fiscal agent, banker and financial adviser. In this capacity it will have the special advantage of its international connections with other central banks and international agencies. In addition, there will be concentrated in this one specialized institution financial operations which are now widely scattered.

#### (7) Central banks in underdeveloped economies

Experience of central banks in underdeveloped economies reveals that such banks need different and wider powers than those in developed economies. Traditional instruments of central bank action, like setting the discount rate or engaging in open market operations, are often ineffective or inappropriate even in highly developed countries like Britain and the United States. In a country like Ceylon,

with its very small capital market, such instruments may be utterly useless. Special problems are also created where the great majority of the credit institutions are foreign owned.

In countries similar to Ceylon, central banks have had to devise new instruments of action. In this way have been developed such instruments as control of reserve requirements, interest rates, portfolio ceilings, capital-asset ratios, and letter of credit margins. These instruments will be discussed in greater detail in the next part of the report.

It is obvious that the resources of the Island cannot be fully developed unless credit is made more freely available. But a central bank cannot force a commercial bank to lend when it does not wish to lend. It is therefore advisable that in Ceylon the Central Bank should have authority to lend at certain times to credit institutions other than commercial banks and that it should have the authority to take measures to reduce some of the unusual risks of lending in Ceylon. For this reason it is recommended that the Central Bank have the authority to lend to mortgage lending institutions and also to the co-operative credit movement, whose sound development in the past indicates that it is a most promising means of making greater credit facilities available to the small farmer. In order to reduce risks of lending in Ceylon the Central Bank should have the authority to act as the agent of the Government in such systems of loan insurance or loan guarantees as may be established in the future.

Like a number of other underdeveloped economies, the Ceylon economy is ordinarily dependent for its prosperity upon the ability to sell a few primary commodities in foreign markets at satisfactory prices. It is therefore peculiarly dependent upon economic conditions abroad, and is especially sensitive to the world business cycle. It would be a mistake to anticipate that the Central Bank will immediately be able to insulate the Ceylon economy against short-run fluctuations in the receipts of the major export industries on which the level of consumption in Ceylon primarily depends. The most that the Bank can do is to help alleviate some of the more serious effects of such fluctuations. In the long run, however, the Bank may be able to do a great deal toward strengthening the economy. By helping to direct the savings and credit resources of the nation, as well as foreign capital, into new agricultural development and new industries, it can stimulate a diversification of the economy which will make it more resilient and adaptable to changing economic conditions abroad.



## PART II.—A DRAFT BILL WITH EXPLANATORY COMMENTS

[Note.—The Clauses of the Bill appear in Latin type and the comments in Roman type.]

An Act to establish the monetary system of Ceylon and the Central Bank to administer and regulate the system and to confer and impose upon the Monetary Board of the Central Bank powers, functions, and responsibilities necessary for the purposes of such administration and regulation, and to provide for connected matters.

BE it enacted by the King's Most Excellent Majesty, by and with the advice and consent of the Senate and the House of Representatives of Ceylon in this present Parliament assembled, and by the authority of the same, as follows :—

1. (1) This act may be cited as the Monetary Law Act, No. of 1949.

Short title and date of operation.

(2) The provisions of this Act other than the provisions of Chapter II thereof, shall not come into operation until such date as may be appointed by the Governor-General by order published in the Gazette.

The draft law has been called a monetary law rather than a central bank law because it is designed to do more than simply provide for the creation of a central bank. Its purpose is to establish an entirely new monetary system for Ceylon which will be administered and regulated by a central bank. A glance at the contents of the Bill will quickly reveal that this central bank is to be much more than a bank for the issue of currency. The intention has been to include in one law all of the provisions normally necessary for the regulation of money and credit. The title, organisation, and compass of the Bill reflect this basic approach. Since demand deposits are a most important form of money, the law regards the commercial banks, which accept and create demand deposits, as an integral part of the country's monetary system, and gives the Central Bank broad authority to control them. Also, since the activities of other lending and investing institutions fundamentally affect the capital market in Ceylon, these institutions, too, are brought under the control of the Central Bank for essential purposes.

## CHAPTER I.—ESTABLISHMENT OF THE MONETARY UNIT

In a monetary law it is appropriate that the first chapter should establish the monetary unit, the foundation stone of the rest of the structure. The chapter defines the Ceylon rupee, establishes its international value in terms of gold, and prescribes its use in Ceylon. The remainder of the draft law is an elaboration of a monetary system based upon the Ceylon rupee as the monetary unit.

2. (1) The standard unit of monetary value in Ceylon shall be the Ceylon rupee, which shall be represented by the signs " Re. " and " Rs. ".

The unit of monetary value.

(2) The Ceylon rupee shall be divided into one hundred units each of which shall be called a " cent ".

3. The par value of the Ceylon rupee shall be two grains and eighty-eight hundredths (2·88) of a grain of fine gold.

The par value of the rupee.

4. (1) Every obligation of the following description, that is to say, every contract, sale, payment, bill, note, instrument, and security for money, and every transaction, dealing, matter, and thing whatsoever relating to money, or involving the payment of money or the liability to pay any money, shall, in the absence of an express agree-

The use of the rupee.



ment to the contrary which is not rendered invalid or unlawful by any other written law, be held to be made, executed, entered into, done, and had in Ceylon according to the Ceylon rupee.

(2) In any case where any such obligation which is by agreement expressed in any monetary unit other than the Ceylon rupee has, by reason that such agreement is rendered invalid or unlawful by any other written law, to be executed or liquidated in Ceylon rupees, the necessary conversions shall be effected on the basis of the legal parities ruling at the time when such obligation falls to be executed or liquidated, or at such other time as may be specified in that behalf in the agreement.

## CHAPTER II.—ESTABLISHMENT OF THE CENTRAL BANK TO ADMINISTER AND REGULATE THE MONETARY SYSTEM

Under the draft law, the Central Bank will be the principal monetary authority, but it is obvious that it cannot exercise its authority in the monetary field as in a water-tight compartment from which the various ministries and other agencies of the Government are excluded. There is no fine line separating monetary policy from other policies, such as fiscal and trade policies. The Minister of Finance through his fiscal policy, or the Minister of Commerce and Trade through his authority to control imports and exports, can exert a powerful influence upon monetary conditions in Ceylon. But it is the clear intent of the Bill to concentrate, in so far as it is considered practicable and constitutional to do, as much monetary authority and responsibility as possible in a single regulatory and operating agency—the Central Bank.

### Part 1.—The Central Bank, its Powers and Purposes

Establishment  
and objects of  
Central Bank.

5. An institution, which shall be called and known as the Central Bank of Ceylon (hereinafter referred to as “the Central Bank”) is hereby established as the authority responsible for the administration and regulation of the Monetary and banking system of Ceylon; and, without prejudice to the other provisions of this Act, the Central Bank is hereby charged with the duty of so regulating the supply, availability, cost and international exchange of money as to secure, so far as possible by action authorised by this Act, the following objects, that is to say:—

- (a) the stabilisation of domestic monetary values;
- (b) the preservation of the par value of the Ceylon rupee and the free use of the rupee for current international transactions;
- (c) the promotion and maintenance of a high level of production, employment, and real income in Ceylon; and
- (d) the encouragement and promotion of the full development of the productive resources of Ceylon.

A central bank influences the economic life of a nation principally by monetary action. While such action can be tremendously effective under certain conditions, its limitations should be frankly recognized. Thus, through its control of money the Central Bank can assist, but by no means ensure, the achievement of the above objects. A monetary system that is stable and at the same time responsive to the needs of a growing country is a necessary but not a sufficient condition of orderly economic development.

An alert reader, especially one who is familiar with the interplay of economic forces, will readily realize the potential conflicts and inconsistencies involved in the above objects. For example, there are times when the stabilization of domestic monetary values would be inconsistent with the preservation of the par value of the rupee and one or the other must give way. Many governments and central banks have tried to promote economic development at the sacrifice of monetary stability. Such conflicts cannot be avoided. Compromise is the essence of every economic decision. It



must remain for those who are charged with the responsibility for determining the policies of the Central Bank constantly to weigh each of the above objects in the balance against the others and to decide from time to time the degree to which it can be achieved or must be sacrificed.

**6. The capital of the Central Bank shall be fifteen million rupees, which sum is hereby appropriated to the Bank from the surplus assets of the Board of Commissioners of Currency as provided in section 128.** Capital of  
Central Bank.

The principal significance of this clause is that it will make the Central Bank a Government-owned bank.

The first central banks were private corporations with boards of directors elected by the shareholders. Indeed, the very first central bank, the Bank of England, was a private corporation from 1694, the date of its incorporation, until 1946, when it was nationalised by the present Labour Government. In the evolution of central banking over the past 250 years there have been many types of ownership : private ownership, public ownership, ownership by the commercial banks, and various combinations of these three. But the trend away from private and toward public ownership has been clearly discernible. Within the Commonwealth, for instance, the only case today of a central bank with a majority of the board of directors elected by private shareholders is that of the Reserve Bank of South Africa. The trend toward public ownership has been particularly pronounced during the last 20 years. The stress of economic events in this period has brought a more complete realization of the proper role of central banking, especially of the very fundamental respects in which central banking differs from commercial banking.

Those who have argued in the past for the private ownership of central banks have usually sought to prove that this device was the best way of ensuring a bank's independence of political influence. Today, however, it has become generally recognized that the control of money should be a public and not a private trust—that it is, in fact, a fundamental prerogative of sovereignty. Governments have always taken full responsibility for such important matters as foreign relations and defence, and in recent years have assumed increasing responsibility in such fields as public health, education, economic development, and even full employment. Surely it is no less appropriate for the Government to take responsibility in the field of monetary management, which affects every individual at a most vital point, his purse.

**7. The Central Bank shall have its principal place of business in Colombo, and may have such branches, agencies, and correspondents in other places, in Ceylon or abroad, as may be necessary for the proper conduct of the business of the Bank.** Place of business

## Part 2.—The Monetary Board

The overall responsibility for the management, operations, and administration of the Central Bank will rest with a Monetary Board. The word “monetary” in its name emphasizes again that the Board is intended to be very much more than simply the board of directors of another bank. It is a Governmental agency responsible for the determination of a particular kind of policy—monetary policy, and the regulation of a particular kind of economic activity—money, banking, and credit.

**8. (1) The Monetary Board of the Central Bank, shall, in addition to determining the policies or measures authorised to be adopted or taken under this Act, be vested with the powers, duties, and functions of the Central Bank under this Act, and be generally responsible for the management, operations, and administration of the Bank.** Constitution  
of Monetary  
Board.

**(2) The Monetary Board shall consist of—**

- (a) the Governor of the Central Bank who shall be the Chairman of the Board ;
- (b) the person holding office for the time being as Permanent Secretary to the Ministry of Finance ; and
- (c) a third member appointed by the Governor-General on the recommendation of the Prime Minister.



(3) In the absence of the Governor from any meeting of the Monetary Board, the Deputy Governor designated as Senior by the Board shall act as his alternate and shall preside at the meeting and have the right to vote thereat.

(4) In the absence of the member of the Monetary Board mentioned in paragraph (b) of sub-section (2) from any meeting of the Board, the person holding office for the time being as Deputy Secretary to the Treasury shall act as that member's alternate at that meeting and have the right to vote thereat.

This clause provides for a monetary board of only three members. Experience in many countries has shown that a small board is likely to be more effective than a large one. Greater prestige attaches to membership on a small board, thus making it easier to attract outstanding men. In contrast with large boards where responsibility often tends to be so diffused that members do not take sufficient interest, a small board makes for a healthy concentration of responsibility. Some central banks, such as the Commonwealth Bank of Australia, have gone so far as to place the entire responsibility for both policy and administration in the Governor of the Bank. There is also an Advisory Council, but as its name implies it is purely advisory. In Ceylon it was considered preferable to adopt the principle of a board in order to preserve the deliberative character of policy-making.

The decision to make the Permanent Secretary to the Ministry of Finance a member of a board of only three grows out of the underlying conception of what the Monetary Board's relations with the Government ought to be. This problem of the relationship of the Central Bank to the Government has vexed law-makers for many years. In most countries the exact relationship has not been precisely defined. However, various legal formulas have been attempted. In Australia, for example, the most recent Commonwealth Bank Act, passed in 1945, provides that the Bank shall from time to time inform the Treasurer of its monetary and banking policy. In the event of a difference of opinion between the Bank and the Government as to whether this policy is directed to the greatest advantage of the people of Australia, the Treasurer and the Bank are to endeavour to reach agreement: if they are unable to do so, the Treasurer may inform the Bank that the Government accepts responsibility for the adoption by the Bank of a policy in accordance with the opinion of the Government. The Bank must then give effect to that policy. The Bank of England Act of 1946, which nationalized the Bank of England, provides that the Treasury can from time to time give such directions to the Bank as, after consultation with the Governor of the Bank, they think necessary in the public interest.

Such a formula may be called for, as it was in England, in order to clarify the relationship between a central bank and a government at the termination of a long period of private ownership and control of the central bank. It does not appear to be necessary in the case of Ceylon where a central bank is being established which from the very beginning is to be entirely under Government auspices. Such formulas come very close to making central banks departments of finance ministries. This might conceivably be done, or it might even be possible to make the Central Bank a separate ministry. There are, however, sound reasons for doing neither—reasons which may be understood in the light of a brief analysis of how a government-owned central bank ordinarily fits into the political and economic structure of a country. From the governmental point of view a central bank is basically an independent, regulatory, and supervisory agency of a type which has become increasingly common in many countries of the world in recent years and in connection with which there has grown up a whole body of administrative practices and political conventions. Central banking embraces problems which are of an unusually technical nature and which require a degree of expertness and specialization not often demanded of Government officials. Also, the administration of a central bank must necessarily be promptly adapted to economic conditions which change rapidly.

From the economic point of view, a central bank puts the government into the business life of a country at especially critical points—namely banking and other credit activities, capital markets, foreign exchange markets, and the supply of hand-to-hand currency. There is a very wide area in which the regulatory functions and



business activities of a central bank are non-policy-making in character. For this reason alone it would be desirable that central banks should be non-political and should have a considerable amount of independence.

There are, however, many important problems of monetary policy, especially those relating to fiscal policy, on which a central bank must necessarily work in close harmony with the government. On such problems experience in many countries has shown that a central bank with a degree of independence of the government proper can make economic analysis and hold views which are more detached and objective than those of a government department. Many governments have learned to value and to use the sort of independent and objective advice on monetary and other aspects of economic policy which central banks have been able to give. On matters of vital interest to the state, however, it must be recognized that even in the absence of some such formula as the British or the Australian, it would be impossible for the Central Bank to adopt a policy or pursue a course of action contrary to the policy of the Government of the day. No agency which is a creature of the Government can be entirely independent of the Government. While the Government may be prepared to give an independent regulatory agency rather wide discretion in a field such as that of money, there is no gain-saying that in the last analysis the Government must assume responsibility for monetary policy as for other policies. The Governor and the appointed member of the Monetary Board cannot help being acutely conscious of the fact that, since no Parliament can bind its successors, their independence and tenure in office under the proposed legislation is limited by the ultimate power of the Government to change the law.

The exact degree and independence of the Central Bank is likely to vary from time to time. For example, central banks, can ordinarily act more independently in stable, peace-time economic conditions than in time of war or other national emergency. They also tend to take stronger stands on issues which are primarily monetary in character than on related issues which may simply have monetary repercussions.

The ideal which it is hoped that the proposed law will achieve is one in which there will be continuous and constructive co-operation between the Monetary Board and the Government. The principal instrument for achieving this co-operation should be the Permanent Secretary to the Ministry of Finance whose membership on the Board will ensure at all times that his Minister's views will be made known to the other members of the Board. The effectiveness of this co-operation and co-ordination between the Board and the Government will depend more upon the men occupying the key positions at particular times than upon any legal formula, no matter how carefully or elaborately it might be worked out. A relationship as complex, and sometimes as delicate, as this one is certain to be, cannot be established full-blown by a piece of legislation. It must be the result, as in other countries, of years of experience and the slow growth of political conventions.

One further point is well worth making. There is a clear need in Ceylon for some sort of economic council at Cabinet level to achieve improved co-ordination of Government economic policies. If in future such a council is set up it is suggested that the Governor of the Central Bank should have a place upon it.

9. (1) The Monetary Board of the Central Bank shall in that name be a body corporate with perpetual succession and a common seal and may sue or be sued in its corporate name.

Monetary Board to be a body corporate.

(2) The Monetary Board shall have the power, in the name of the Central Bank, to hold property, both movable and immovable, and to sell and dispose of the same, to enter into contracts and otherwise to do and perform all such acts or things as may be necessary for the purpose of carrying out the principles and provisions of this Act.

(3) The Monetary Board may, in the name of the Central Bank, acquire and hold such assets and incur such liabilities as result directly from operations authorised by this Act or as are essential for the proper conduct of such operations.

Since it is better in legal theory to incorporate a body of persons rather than an institution, clause 9 of the Bill will incorporate the Monetary Board, rather than the Central Bank, and give it perpetual succession and the right to sue and be sued.



General powers  
of Monetary  
Board.

10. For the purposes of the exercise of its powers, duties, functions, and responsibilities under this Act, the Monetary Board—

- (a) may, subject to the provisions of section 22 and section 23, appoint such officers and servants as the Board may consider necessary and remove them from office or dismiss them, and may fix the salaries or wages, or other remuneration, of such officers and servants, and may prescribe their conditions of service ;
- (b) may establish and regulate pensions or provident funds or schemes for the benefit of officers and servants and their dependants and nominees, and may make contributions to any such fund or scheme ;
- (c) may make such rules and regulations as the Board may consider necessary in relation to any matter affecting or connected with or incidental to the exercise, discharge, or performance of the powers, functions, and duties of the Central Bank ; and
- (d) may utilise the funds of the Central Bank for the purpose of meeting all expenditure incurred by the Board in the management, administration, and operation of the Bank and in the exercise, performance, and discharge of powers, functions, and responsibilities of the Bank under this Act.

Disqualification  
for appointment  
as Governor,  
or as member of  
Monetary Board.

11. A person shall be disqualified for appointment as the Governor of the Central Bank or a member of the Monetary Board under paragraph (c) of section 8 (2), if—

- (a) he is a Senator or a Member of Parliament or a member of any local authority ; or
- (b) he is a public officer or a judicial officer within the meaning of the Ceylon (Constitution) Order in Council, 1946, or holds any office or position (other than an academic position), either by election or appointment, for which salary or other remuneration is payable out of public funds or the funds of any local authority ;
- (c) he is a director, officer, employee, or shareholder of any banking institution (other than the Central Bank).

Appointment,  
remuneration,  
&c., of Governor  
of Central Bank.

12. (1) The Governor of the Central Bank shall be a person appointed for the purpose by the Governor-General on the recommendation of the Prime Minister.

(2) The Governor shall devote his full professional time to the business of the Bank ; and accordingly the Governor shall not accept or hold any other office or employment whatsoever, whether public or private, and whether remunerated or not :

Provided, however, that nothing in the preceding provisions of this sub-section shall be deemed to prevent the Governor from accepting or holding any academic office or position, or from being appointed to be or acting as a member of any commission constituted under the Commissions of Inquiry Act, No. 17 of 1948, for the purposes of any inquiry relating to monetary, banking, financial, or general economic matters or questions affecting the national welfare of Ceylon, or of any council, committee, or other body investigating or examining, or advising upon, any such matters or questions.

(3) The Governor shall receive such salary as may be fixed by the Governor-General on the recommendation of the Prime Minister.

13. (1) The term of office of the Governor, and of the person appointed under paragraph (c) of section 8 (2) (hereinafter referred to as the "appointed member", shall, subject to the provisions of sub-section (2) of this section, be the period of six years commencing on the date of his appointment :

Term of Office of Governor and appointed member.

Provided, however, that the term of office of the first appointed member holding office under this Act shall be the period of three years from the date of his appointment.

This provision will achieve the staggering of the terms of the Governor and the appointed member, so that one or the other will be appointed every 3 years.

(2) In the event of the vacation of office by the Governor or by the appointed member before the expiration of his term of office, another person shall be appointed in his place to hold office during the unexpired part of the term of office of the Governor or member so vacating office.

(3) Any person vacating office as Governor or as appointed member by effluxion of time shall be eligible for re-appointment.

14. (1) The appointed member shall receive an allowance for each day on which he attends a meeting of the Monetary Board.

Remuneration of appointed member.

(2) The amount of such allowance shall be fixed by the Governor-General on the recommendation of the Prime Minister.

15. (1) Where the appointed member is, through illness, absence from Ceylon, or for any other reason, temporarily unable to perform the functions of his office, the Governor-General may, on the recommendation of the Prime Minister, appoint some other person to act in his place for such period as may be specified by the Governor-General.

Alternate for appointed member.

(2) The provisions of section 11 shall apply in relation to any such appointment.

(3) The person appointed to act as a member of the Board under this section shall during the period of his appointment be deemed for the purposes of this Act to be the appointed member.

16. The Governor-General may, on the recommendation of the Prime Minister, remove the Governor or the appointed member from office—

Removal from office of Governor or appointed member.

(a) if he becomes subject to any disqualification mentioned in section 11 ; or

(b) if he becomes permanently incapable of performing his duties ; or

(c) if he has done any act or thing which, in the opinion of the Prime Minister, is of a fraudulent or illegal character or is manifestly opposed to the objects and interests of the Central Bank ; or

(d) in the case of the Governor, if he acts in contravention of sub-section (2) of section 12.

17. (1) Meetings of the Monetary Board shall be held at least once in every two weeks and, in addition, as frequently as is necessary for the purpose of the discharge of its responsibilities under this Act.

Meetings of Monetary Board

(2) Meetings of the Board shall be convened by the Governor.

(3) At any meeting of the Board two members shall constitute a quorum.

(4) No decision taken at any meeting of the Board shall be deemed to be a decision of the Board unless it has the concurrence of at least two members, or, in any case where any other provision of this Act requires a unanimous decision, the concurrence of all three members.



Attendance of  
certain officers  
at meetings of  
Monetary Board.

18. The Deputy Governor designated as Senior by the Monetary Board and the Director of Economic Research may attend meetings of the Monetary Board, but shall not have the right to vote on any question.

General  
functions and  
duties of  
Governor.

### Part 3.—The Governor and Deputy Governors

19. (1) The Governor shall be the Chief executive officer of the Central Bank and shall accordingly be charged with the following powers, duties, and functions :—

- (a) the execution of policies and measures approved by the the Monetary Board and subject to any such policies and measures as may be applicable, the direction, supervision, and control of the operations of the Central Bank and its internal management and administration ;
- (b) the preparation of the agenda for meetings of the Monetary Board and the submission for the consideration of the Board of policies and measures considered by him to be necessary for the purpose of carrying out the principles and provisions of this Act ; and
- (c) the exercise or performance of such other powers or duties as may be conferred or imposed upon him by the Monetary Board.

(2) Every instrument of the following description, that is to say, every contract, promissory note, security, report, balance sheet, statement, or other document, and every rule, regulation, order, direction, notice, or requirement which bears the signature of the Governor or such other officer as may be authorised in that behalf by the Monetary Board, shall be deemed for all purposes to be an instrument executed, made, or issued by the Central Bank or by the Monetary Board, as the case may be.

Although the ultimate authority rests in the Monetary Board, the draft law nevertheless recognizes the need for a strong chief executive for the Central Bank. Accordingly the Governor is made the Chairman of the Monetary Board, and is given control of the agenda for its meetings. He is to be responsible for the execution and administration of policies and measures adopted by the Monetary Board, for the direction, supervision and control of the operations of the Central Bank, and for its internal management and administration. He is to be chief representative of the Bank in its relations with outside persons, including the Government and its agencies, foreign governments and their agencies, and international financial and other institutions. He will be required to devote his full professional time to the business of the Central Bank. Since the other two members of the Monetary Board will be part-time members and because the problems facing central bankers are frequently complex and technical, it is to be expected that the full-time Governor will ordinarily be the most influential member of the Board and will tend to dominate it. Accordingly, the Governor should be a man of recognized and outstanding competence in and understanding of the economic and financial problems of Ceylon, and of unquestioned integrity and responsibility. In order to attract such a man it is recommended that his salary be set at the highest possible level not inconsistent with remuneration in top-ranking posts elsewhere in the Government and its agencies.

It is important that the Governor should have had actual financial experience. In many countries this point has actually been incorporated in legislation, as the following quotation from De Kock's book on Central Banking shows :

“ . . . in the case of some central banks it has been laid down by statute that the Governor and Deputy-Governor shall be ‘ men of proven financial experience ’, as in Canada, or ‘ persons possessed of actual banking experience ’, as in New Zealand, or ‘ persons of recognized banking and financial experience ’ as in Argentina, or that the Governor shall be a ‘ person of tested banking experience ’, as in the Union of South Africa and Mexico ”.



20. The Governor of the Central Bank shall be the principal representative of the Bank and of the Monetary Board and shall in this capacity, but in accordance with policies or rules approved or made by the Board, have authority—

Governor to be principal representative of Central Bank and Monetary Board.

- (a) to represent the Central Bank and the Board in all relations with other persons, including the Government and any body of persons, corporate or unincorporate, whether public or private, domestic, foreign, or international; and
- (b) to represent the Central Bank and the Board in any legal proceeding either personally or through proctor or counsel.

21. Subject to and in accordance with such rules, if any, as may be made by the Monetary Board in that behalf, the Governor may delegate to any other officer of the Bank his authority to represent the Bank for any purpose mentioned in section 20, so however that the Governor shall remain and continue to be responsible to the Board for and in respect of any act or thing done or omitted to be done by any such delegate.

Delegation of powers of Governor.

22. The Monetary Board shall, with the concurrence of the Minister of Finance, appoint one or more Deputy Governors who shall perform such duties and exercise such powers as may be assigned to them by the Board.

Appointment of Deputy Governors.

23. (1) A person shall be disqualified for appointment as a Deputy Governor if—

Disqualification and removal of Deputy Governors.

- (a) he is a Senator or a Member of Parliament or a member of any local authority;
- (b) he is a public officer or a judicial officer within the meaning of the Ceylon (Constitution) Order in Council, 1946, or holds any office or position (other than an academic position), either by election or appointment, for which salary or other remuneration is payable out of public funds or the funds of any local authority; or
- (c) he is director, officer, employee, or shareholder of any banking institution (other than the Central Bank).

(2) The Monetary Board may with the concurrence of the Minister of Finance remove any Deputy Governor from office—

- (a) if he becomes subject to any disqualification mentioned in sub-section (1); or
- (b) if he becomes permanently incapable of performing his duties; or
- (c) if he has done any act or thing which, in the opinion of the Board, is of a fraudulent or illegal character or is manifestly opposed to the objects and interests of the Central Bank; or
- (d) if, in the opinion of the Board, he has failed to carry out his duties.

24. In the event of the temporary absence from duty of the Governor or of the temporary inability of the Governor to perform his functions and duties, the Deputy Governor designated as Senior by the Board shall act as the chief executive officer of the Central Bank and shall have authority to exercise the powers and perform the duties of the Governor under this Act.

Deputy Governor to act as Governor.

#### Part 4.—Departments of the Central Bank

The only two departments specifically provided for by the draft law are the Department of Economic Research and the Department of Bank Supervision.



## A.—The Department of Economic Research

Establishment  
and functions  
of Department  
of Economic  
Research.

25. (1) The Central Bank shall establish and maintain a Department of Economic Research which shall prepare data and conduct economic research, for the guidance of the Monetary Board and the Governor in formulating, implementing, and executing policies and measures and for the information of the public, in the subjects of money and banking and other economic subjects of general interest.

(2) The head of the Department established under sub-section (1) shall be called the Director of Economic Research.

The Department of Economic Research is given special recognition in the draft law in order to emphasize its importance. While there may be a tendency in highly developed countries to attach too much importance to economic research, the opposite is more likely to be true in underdeveloped countries. It is to be hoped that the Central Bank will be able to demonstrate in Ceylon how much a properly organized and adequately supported research unit can contribute to the formation of policy. It may not be too much to say that the solid achievements of the Central Bank in the years to come will depend as much upon the successful development of this department as upon anything else.

Authority to  
obtain  
information.

26. (1) The Director of Economic Research or any officer of the Department of Economic Research authorised for the purpose by the Director may in such manner as may be prescribed by rules made under section 10—

(a) require any person to furnish to him such information as he may consider it necessary to obtain for the purposes of the proper discharge of the functions and responsibilities of the Central Bank ; or

(b) require any person to produce for inspection any books or records in his possession containing or likely to contain any such information.

(2) Any person who without reasonable cause fails or refuse to comply with any requirement made under sub-section (1) shall be guilty of an offence.

(3) In this section “ person ” includes any officer of any Department of Government, and any body of persons, corporate or unincorporate, whether established or constituted under any written law or otherwise.

Training of  
technical  
personnel.

27. The Central Bank shall promote and sponsor the training of technical personnel in the subjects of money, banking, statistics, finance, and other economic subjects and for this purpose, the Central Bank is hereby authorised to defray the costs of study, in Ceylon or abroad, of employees of the Bank who are of proved merit, or of any other qualified persons selected by the Monetary Board.

## B.—Department of Bank Supervision

The Department of Bank Supervision has been specifically mentioned both because of the importance of its work and because of the novelty of the principle of bank supervision in Ceylon. Also, it is essential that the functions, authority, and powers of the Department be accurately and carefully defined.

Establishment  
and functions  
of Department  
of Bank  
Supervision.

28. (1) for the purposes of the continuous supervision and periodical examination of all banking institutions in Ceylon, the Central Bank shall establish and maintain a Department of Bank Supervision.

(2) The head of the department established under sub-section (1) shall be called the Director of Bank Supervision.

Supervision of banks by the Central Bank or some other supervisory authority has proved in the experience of many countries to be an important means of contributing to the soundness of the banking system. Banking is an economic activity which

affects the public welfare to an unusual degree ; it touches in one way or another almost every phase of a country's economic life. Sound banking is essential to healthy and vigorous economic development. Supervision of banks helps to protect the public against mismanagement, bank failures, and loss of confidence in the banking system. It helps to protect depositors and stock-holders against loss, and frequently enables bank directors and officers to manage the affairs of their banks more wisely and intelligently.

In Ceylon, where most banks are branches of foreign banks, supervision is particularly necessary. So recently as April of this year a foreign bank with a branch in Colombo failed with resulting loss to Ceylon depositors. The Central Bank should have the power to protect depositors against such loss in the future. In addition to the protection afforded by supervision, the bill gives the Monetary Board the special authority contained in clause 77 (2).

29. (1) The Director of Bank Supervision shall examine, or cause an Examiner of his Department to examine, the books and accounts of every commercial bank in Ceylon at least once in each examination period, and shall make such further examinations in respect of any specified bank whenever required so to do by the Governor.

Examination of  
banking  
institutions.

(2) Examination of the books and accounts of banking institutions other than commercial banks, or of any specified institution, shall be made if directions in that behalf are given by the Monetary Board.

(3) A report on the results of each examination under this section shall be furnished by the Director of Bank Supervision to the Governor.

(4) It shall be lawful for the Director of Bank Supervision or for any Examiner of his Department—

- (a) to administer oaths or affirmations, in accordance with the Oaths Ordinance, to any director, officer, or employee of any banking institution ;
- (b) to require any such director, officer, or employee to furnish such information as the Director or Examiner may consider it necessary to obtain for the purpose of enabling the true condition of the affairs of the institution to be ascertained ; or
- (c) to require any such director, officer, or employee to produce for inspection any books, records, or other documents in his possession containing or likely to contain any such information.

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(5) It shall be the duty of every director, officer, or employee of any banking institution to afford to the Director of Bank Supervision or to any Examiner of his Department full opportunity to examine books and records and its cash, available assets, full liabilities and general condition, whenever so requested by the Director.

(6) In this section “ examination period ” means each period of such duration as may be fixed for the purpose by the Monetary Board.

30. (1) In any case where the Director of Bank Supervision is satisfied, after examination by himself or any Examiner of the affairs of any banking institution, or upon information received from the institution, that the institution is insolvent or is likely to become unable to meet the demands of its depositors, or that its continuance in business is likely to involve loss to its depositors or creditors, the Director shall make a report accordingly to the Governor for submission to the Monetary Board ; and if the Board, upon review of the facts and circumstances, is of opinion that action should be taken as hereinafter provided, the Board may make order directing the institution forthwith to suspend business in Ceylon and directing the

Power of Monetary Board to suspend or restrict business of a banking institution.



Director to take charge of all books, records and assets of the institution and to take such measures as may be necessary to prevent the continuance of business by the institution.

(2) Notwithstanding anything in any written or other law, no action or proceeding may be instituted in any court for the purpose of securing the review or revocation of any order made under sub-section (1) or in respect of any loss or damage incurred, or likely to be or alleged to be incurred, by reason of such order.

(3) An order made by the Board under sub-section (1) in respect of any banking institution shall cease to have effect upon the expiration of a period of thirty days from the date on which it is made ; and it shall be the duty of the Board, as soon as practicable and in any event before the expiration of the said period—

- (a) to make order permitting the institution to resume business, either unconditionally or subject to such conditions as the Board may consider necessary in the public interest or in the interests of the depositors and other creditors of the institution ; or
- (b) to cause the Director of Bank Supervision to make application to the competent court under such written law as may be applicable in that behalf for the winding-up of the institution.

(4) Where an order has been made by the Monetary Board under sub-section (3) permitting the resumption of business by any banking institution subject to such conditions as may be specified in the order, the competent court may, on application made to it in that behalf by the banking institution at any time while the order is in force, make a declaration permitting the institution to resume business unconditionally, or varying or altering, in such manner as the court may determine, any or all of the conditions specified by the Board ; and any such declaration shall have effect notwithstanding anything in the order made by the Board under sub-section (3).

The Director of Bank Supervision shall be named respondent to any such application and shall be entitled on behalf of the Board to be heard and to adduce evidence at the hearing thereof.

(5) In any case where application is made by the Director as provided in sub-section (3) for the winding-up of any banking institution—

- (a) the institution shall not carry on business during the pendency of the application unless it is authorised so to do by the court and except in accordance with such conditions, if any, as may be specified by the court ; and
- (b) the court, if it is of opinion after such inquiry as it may consider necessary, that the institution is not insolvent, may make a declaration permitting the institution to resume business either unconditionally or subject to such conditions as the court may consider necessary in the public interest or in the interests of the depositors and other creditors of the institution.

(6) Every order made by a competent court under this section shall be subject to an appeal to the Supreme Court and the provisions of the Civil Procedure Code relating to appeals in civil actions shall apply *mutatis mutandis* in the case of any such appeal :

Provided that in order under paragraph (a) of sub-section (5) shall be final and shall not be subject to appeal.

(7) Every application to a competent court under this section shall be deemed to be an action of the value of five thousand rupees,

(8) In this section, "competent court", in relation to any banking institution, means the District Court of Colombo or of the district in which the principal office in Ceylon of the institution is maintained.

(9) Nothing in this section shall apply to or in relation to any banking institution unless it is an institution that is subject to or governed by any other written law which confers power to order winding-up or liquidation.

31. In any case where an order is made, whether in pursuance of an application under section 30 or otherwise, for the winding-up of any banking institution, then, notwithstanding anything in any other written law, the Director of Bank Supervision shall be appointed to be the liquidator for the purposes of such winding-up.

Director of Bank Supervision to be liquidator in winding-up of a banking institution.

32. (1) Any owner, agent, director, officer, or employee of any banking institution, who fails to furnish any information or to produce any book, record, or other document when required so to do by the Director of Bank Supervision or any Examiner under the preceding provisions of this Part or who obstructs or fails to permit the Director or any Examiner to make any examination authorised to be made under any such provision, shall be guilty of an offence.

Offences in regard to information and examinations.

(2) Any person who in any report or information furnished to the Director of Bank Supervision, or to any Examiner, makes any statement which he knows to be false shall be guilty of an offence.

### C.—Other Departments

33. The Monetary Board may establish and maintain such other departments as it may consider necessary for the proper and efficient conduct of the business of the Central Bank.

Other departments.

It has not been considered desirable to provide specifically for the other departments of the Bank in the draft legislation. Their establishment and functions are better left to the determination of the Monetary Board. It should be particularly mentioned, however, that the Central Bank will have to have an exchange control department as long as exchange control legislation is in force. In other countries too, central banks ordinarily do the bulk of the work of operating the exchange control. In Ceylon the department of the Ministry of Finance which now does this work will be eliminated.

### Part 5.—Reports and Publications

34. The Central Bank, shall before the eighth day of each month, publish a general balance sheet showing the volume and composition of its assets and liabilities as on the last working day of the preceding month.

Monthly Statement.

35. (1) Within three months after the end of each financial year, the Monetary Board shall submit to the Minister of Finance and shall publish an Annual Report on the condition of the Central Bank and a review of the policies and measures adopted by the Monetary Board during the financial year and an analysis of the economic and financial circumstances which prompted those policies and measures.

Annual Report.

(2) The Annual Report shall include a statement of the financial condition of the Central Bank, and shall present as a minimum the following data :—

- (a) the monthly movements of the money supply, distinguishing between currency and demand deposits ;
- (b) the monthly movements of purchases and sales of exchange and of the International Reserve of the Bank ;



- (c) the annual balance of payments of Ceylon ;
- (d) the monthly indices of wages, of the cost of living and of import and export prices ;
- (e) the monthly movement, in summary form, of exports and imports, by volume and value ;
- (f) the monthly movement of the accounts of the Central Bank and, in consolidated form, of the commercial banks ;
- (g) the principal data on Government receipts and expenditures and on the state of the public debt, both domestic and foreign ; and
- (h) the texts of the major legal enactments and administrative measures adopted by the Government and the Monetary Board during the year, which relate to the functions or operations of the Central Bank or of banking institutions operating in Ceylon.

(3) The Annual Report shall be laid before Parliament within fourteen days after the receipt thereof by the Minister of Finance, if Parliament is then in session, or, if Parliament is not in session, within fourteen days after the commencement of the next ensuing session.

Signatures on balance sheets and financial statements.

36. The balance sheets and other financial statements of the Central Bank (including the statement of financial condition referred to in section 35 (2) shall be signed by the Governor and the Chief Accountant of the Bank, and shall be certified by the Auditor.

#### Part 6.—Profits, Losses, and Special Accounts

Financial Year.

37. The financial year of the Central Bank shall be the calendar year.

Two principal considerations have dictated the decision to make the financial year of the Central Bank the calendar year rather than the Government's financial year, which ends on September 30. One is that the Central Bank, as banker and fiscal agent of the Government, will have a heavy load of accounting and record work to be done for the Government at the end of the Government's financial year. The Central Bank should not have to close its own books and prepare its own annual report at this same time. Second, the Bank's annual report, which is required to be submitted to the Minister of Finance within three months from the end of the financial year, can contain more complete and accurate data on Government receipts and expenditures for the preceding financial year if it can appear on March 31, rather than on December 31.

Computation of profits and losses.

38. Before the expiration of thirty days after the end of each financial year, the Central Bank shall determine its net profits or losses, and in the calculation of net profits the Bank shall make adequate allowance or establish adequate reserves for such purposes as the Monetary Board may deem fit.

Distribution of profits.

39. Before the expiration of sixty days after the end of each financial year, the Monetary Board shall carry out the distribution of the net profits in accordance with the following provisions :—

- (a) Firstly, all the net profits of the Central Bank shall be used to reduce the Monetary Adjustment Account, defined in the following section, whenever such Account exists, until the Account has been completely liquidated.
- (b) Secondly, any net profits remaining after liquidation of the Monetary Adjustment Account, if any, shall be carried to surplus until such time as the total capital accounts of the Bank reach a sum equal to at least fifteen per centum of the total assets of the Bank less its assets in gold and in foreign currencies.

- (c) Thirdly, any net profits remaining after compliance with the preceding provisions shall, after consultation with the Minister of Finance, either be applied in liquidation of any outstanding Government obligations to the Central Bank or be paid and credited to the Consolidated Fund.

Central Bank profits deserve special attention because of the inflationary or deflationary effects which their payment or non-payment can have on an economy. For example, when such profits are paid out and spent by a Government a considerable proportion of them will find its way into the reserves of the commercial banks and thus form the basis for an expansion of bank credit. The purpose of clause 39 of the Bill is to prevent such an expansion whenever the Central Bank has itself contributed to inflationary pressures by increasing its domestic assets. For the Bank's assets other than those in gold and foreign currencies will consist principally of advances and discounts to commercial banks and of holdings of Government securities. If either of these types of assets has increased too rapidly, it is likely that the provision of paragraph (b) of clause 39 will require the Central Bank to retain its profits by having them carried to surplus, and thus prevent them from adding to the expansion of central bank credit. On the other hand, if such assets have not expanded, there should be no ill effects from paying out the Central Bank's profits to the Government, especially since in this case the Government could not have been obtaining excessive accommodation from the Central Bank. When profits are paid to the Government, it is for the Minister of Finance and the Monetary Board to determine whether to use the profits to retire Government obligations owned by the Central Bank, which would again prevent the profits from having inflationary effects, or to pay them to the Consolidated Fund.

40. The Monetary Board may, whenever it deems it advisable, exclude from the computation of the annual profits and losses of any particular financial year all or any part of any extraordinary expenses of the following description which may have been incurred during that year :—

Extraordinary expenses of currency issue and monetary stabilization.

- (a) The costs of any extraordinary coin or note issue.
- (b) Expenditures incurred in the issue and placing of, and the payment of interest on, the securities to which reference is made in section 90.
- (c) Interest paid on bank reserves in accordance with section 94.

The amounts so excluded from the computation of profits and losses shall be entered in a suspense account which shall be called the "Monetary Adjustment Account". The expenses charged to such Account shall in every case be amortized not later than five years after they are so charged.

41. (1) Profits or losses arising from any revaluation of the Central Bank's net assets or liabilities in gold or foreign currencies as a result of changes in the par value of the Ceylon rupee or of changes in the parities or exchange rates of foreign currencies with respect to the Ceylon rupee, or profits or losses assumed by the Central Bank in accordance with the provision of section 78, shall not be included in the computation of the annual profits and losses of the Central Bank.

Revaluation Profits and losses.

(2) All such profits or losses shall be carried in a special account, which shall be named "International Reserve Revaluation Account", and the net balance of which shall appear either among the liabilities or among the assets of the Central Bank, according as the revaluations have produced net profits or net losses.

(3) The International Reserve Revaluation Account shall be neither credited nor debited for any purposes other than those specifically mentioned in this section.



The purpose of this clause is to provide that all profits and losses of the Central Bank resulting from changes in the par value of the Ceylon rupee or from changes in the parities of exchange rates of other currencies with respect to the Ceylon rupee should be sterilized. The profits or losses which the Central Bank assumes from banking institutions according to the provisions of clause 78 of the Bill are also to be sterilized. These are actually book-keeping profits and losses which the Central Bank in effect assumes for the country as a whole. If they were not sterilized they could lead to perverse results. In the event of unilateral devaluation by Ceylon, the Central Bank would make a substantial profit on a very large proportion of the country's holdings of gold and foreign exchange. If such profits were taken by the Bank, they would immediately increase the proportion of the Bank's international to its domestic assets and might stimulate the Monetary Board to engage in an expansion of credit which would nullify much of the benefit of the devaluation. On the other hand the knowledge that an appreciation of the currency would result in heavy losses for the Central Bank might deter the Monetary Board from recommending this course at times when on other grounds it might be highly desirable.

#### Part 7.—The Auditor

##### Appointment and staff.

42. (1) The accounts of the Central Bank shall be subject to audit by the Auditor of the Central Bank who shall be appointed, and may be removed from office, by the Governor-General upon the recommendation of the Minister of Finance.

(2) The Auditor shall have such number of Assistants and members of his minor staff as may be determined by the Minister of Finance.

(3) The Auditor, with the approval of the Minister of Finance shall appoint, and may remove from office, his Assistants and minor staff.

(4) The salaries of the Auditor and his Assistants and minor staff shall be determined by the Minister of Finance, and, together with all other expenses of the Auditor's office, shall be paid by the Central Bank.

(5) The persons appointed under this section shall, for all purposes other than discipline or removal from office, be deemed to be officers or servants of the Central Bank and shall devote their full time to the performance of their functions and duties under this Act.

##### Powers and functions.

43. (1) The Auditor and his Assistants shall at all times have the right of access to, and examination of, the accounts of the Central Bank and of all books and documents containing information with respect to matters connected with such accounts.

(2) The Auditor shall at such intervals as may be fixed by the Minister of Finance furnish to him reports setting out the results of the examination of the accounts of the Central Bank.

#### Part 8.—Restrictions relating to Central Bank Officers and Servants

##### Persons interested in banking institutions not eligible for employment by Central Bank.

44. No person shall be eligible for employment as an officer or servant of the Central Bank, if he is a director, officer or employee, or a shareholder, whether directly or beneficially, of any banking institution.

##### Duty to maintain secrecy.

45. Except in the performance of his duties under this Act, every officer or servant of the Central Bank shall preserve and aid in preserving secrecy with regard to all matters relating to the affairs of any banking institution, or of any client of any such institution, that may come to his knowledge in the performance of his duties ; and any such officer or servant who communicates any such matter to any person



other than the Monetary Board or an officer of the Central Bank authorised in that behalf by the Governor, or suffers or permits any unauthorised person to have access to any books, papers, or other records relating to any banking institution, shall be guilty of an offence.

(2) No officer or servant of the Central Bank shall be required to produce in any court any book or document or to divulge or communicate to any court any matter or thing coming under his notice in the performance of his duties under this Act, except as may be necessary for the purpose of carrying into effect the provisions of this Act.

46. Any member of the Monetary Board or any officer or auditor of the Central Bank who certifies or verifies any statement, account, or list required to be furnished to the Minister of Finance in pursuance of this Act, knowing the same to be false in any material particular shall be guilty of an offence.

47. (1) No member of the Monetary Board or officer or servant of the Central Bank shall be liable for any damage or loss suffered by the Bank unless such damage or loss was caused by his misconduct or wilful default.

(2) Every member of the Monetary Board and every officer or servant of the Central Bank shall be indemnified by the Bank from all losses and expenses incurred by him in or about the discharge of his duties, other than such losses and expenses as the Board may deem to have been occasioned by his misconduct or wilful default.

Liability for  
false statements  
in Central  
Bank accounts  
&c.

Protection for  
acts done in  
good faith, &c.

### CHAPTER III.—THE CENTRAL BANK AND THE MEANS OF PAYMENT

Chapter III emphasizes that demand deposits, like currency, are a means of payment. The bill explicitly recognises that commercial banks create demand deposits and at the same time makes their creation subject to the control of the Monetary Board of the Central Bank.

#### Part 1.—Issue of Means of Payment

##### A.—Currency

48. In this Act, "currency" means all currency notes and coins issued or circulating in accordance with the provisions of this Act.

49. The Central Bank shall have the sole right and authority to issue currency in Ceylon.

50 (1) No person other than the Central Bank shall draw, accept, make, or issue any bill of exchange, promissory note, or engagement for the payment of money payable to bearer on demand, or borrow, owe, or take up, any sum or sums of money on the bills, or notes payable to bearer on demand of any such person :

Provided that cheques or drafts payable to bearer on demand may be drawn on commercial banks or agents by their customers or constituents in respect of moneys in the hands of such banks or agents held by them at the disposal of the person drawing such cheques or drafts.

(2) Every person who contravenes any provision of this section shall be guilty of an offence.

51. Currency notes and coins issued by the Central Bank shall be liabilities of the Bank. The Bank's holdings of its own notes and coins shall not be considered as part of its currency issue and, accordingly, shall not be taken into account in determining the assets or liabilities of the Bank.

52. All currency notes and coins issued by the Central Bank shall be legal tender in Ceylon for the payment of any amount.

Definition of  
currency.

Issue powers.

Prohibition  
against issue  
of notes by  
any person other  
than Central  
Bank.

Liability for  
notes and coins.

Currency to be  
legal tender.



Characteristics  
of currency.

53. (1) The Monetary Board shall, with the approval of the Minister of Finance, prescribe the denominations, dimensions, designs, inscriptions, and other characteristics of currency notes issued by the Central Bank.

(2) Every currency note shall bear the signatures in facsimile of the Minister of Finance and of the Governor of the Central Bank and shall be stated on the face thereof to be issued on behalf of the Government of Ceylon.

(3) The Monetary Board, shall, with the approval of the Minister of Finance, prescribe the metals, fineness, weight, size, designs, denominations, and other characteristics of the coins issued by the Central Bank.

Contracts for  
printing of  
notes and  
minting of coins.

54. The Central Bank shall have the authority to enter into contracts with other persons in Ceylon or abroad for the printing of currency notes and the minting of coins.

Exchange of  
currency.

55. Upon surrender by any person to the Central Bank of any Ceylon currency, the Bank shall deliver to that person in exchange, on demand and without charge, Ceylon coins and currency notes of equivalent value in such denominations as may be required by that person :

Provided that if the Bank is temporarily unable to deliver currency notes or coins of any required denomination, the Bank shall be deemed to comply with its obligation if it delivers notes or coins of the next higher or next lower available denomination.

Replacement of  
currency unfit  
for circulation.

56. The Central Bank shall withdraw from circulation and shall cancel all currency notes and coins which for any reason whatsoever are unfit for circulation, and shall, as soon as practicable and subject to such rules and regulations as may be made in that behalf by the Monetary Board, with the approval of the Minister of Finance replace them by the delivery in exchange of fit notes and coins.

Retirement of  
old notes and  
coins.

57. (1) The Monetary Board may in its discretion, by notice published in the *Gazette*, call in for replacement currency notes or coins of any issue or denomination.

(2) Notes and coins called in for replacement in accordance with this section shall remain legal tender for a period of one year from the date of call and shall thereafter cease to be legal tender.

(3) During the period of five years succeeding the date of call, or such longer period as the Monetary Board may determine, the Central Bank or any agent authorised by the Board for the purpose, shall, upon surrender of any currency notes or coins so called in for replacement, replace such notes or coins, at par and without charge, by the delivery in exchange of fit notes or coins. All currency notes and coins so surrendered shall be demonetized by the Bank.

(4) All currency notes and coins called in for replacement and not surrendered as provided in sub-section (3) shall cease to be a liability of the Central Bank and shall be demonetized without compensation to the bearer.

Mutilation or  
defacement of  
currency notes.

58. Any person who without the authority of the Monetary Board—

(a) cuts, perforates, or in any other way whatsoever mutilates any currency note,

(b) prints, stamps, or draws anything upon any currency note, or affixes any seal or stamp to or upon any currency note, or

(c) attaches or affixes to or upon any currency note anything in the nature or form of an advertisement,

shall be guilty of an offence.

**B.—Demand Deposits**

59. For the purposes of this Act, “demand deposits” means all those liabilities of the Central Bank and of commercial banks which are denominated in Ceylon currency and are subject to withdrawal in legal tender upon demand by cheque, draft, or order.

Definition of “demand deposits”.

60. The acceptance or creation of demand deposits shall be subject to the control of the Monetary Board in accordance with the powers granted to the Board under this Act.

Acceptance and creation of demand deposits.

**Part 2.—The Money Supply**

61. For the purposes of this Act, “the money supply” means all currency and demand deposits owned by persons other than commercial banks or the Government.

Definition of “the money supply”.

The purpose of this clause is to distinguish “money supply” from “means of payment”. This is especially necessary at this point in the Bill, because hereafter the term “money supply” is used repeatedly.

**CHAPTER IV.—THE CENTRAL BANK AND NATIONAL MONETARY POLICY**

Chapter IV. contains the principles governing the determination of national monetary policy by the Monetary Board, and prescribes the action that the Board should take when the success of its policy is threatened. These principles will by no means make sound management of the Ceylon monetary system automatic : they simply provide certain safeguards and danger signals, and clarify the intent of the draft law with respect to the use of the powers it contains. In a country with a well established body of tradition in the field of central banking such principles would be unnecessary. They have been set forth here in the hope that they will prompt the Monetary Board to take action when action is needed, and, conversely, to refrain from action when it is not needed.

**Part 1.—Domestic Monetary Stabilization**

62. (1) The Monetary Board shall endeavour so to regulate the supply, availability, and cost of money as to secure, so far as possible by action authorised by this Act, the objects mentioned in section 5 ; and shall for such purpose have regard to the monetary needs of particular sectors of the economy as well as of the economy as a whole.

Principles governing determination of domestic monetary policy.

(2) In determining its domestic monetary policies the Monetary Board shall especially consider their effects on Ceylon's international financial position as evidenced by the relation of domestic to world prices and costs, by the level and composition of exports and imports, by the international balance of payments, and ultimately, by the ability of the Central Bank to maintain the international stability of the Ceylon rupee and its free convertibility for current international transactions.

It has already been explained in Part I. of this report that one of the greatest disadvantages of the present monetary system is that it can do nothing to make more credit available to meet the growing needs of an expanding economy. The Central Bank can remedy this defect through its ability to expand and contract credit to meet changing domestic requirements. Clause 62 of the Bill emphasizes, however, that the domestic monetary policy cannot be determined in disregard of its effects upon Ceylon's international financial position.

Much has been written in recent years of the benefits which a country can derive from policies such as deficit financing and cheap money in conditions of underemployment. Since Ceylon has chronic underemployment, it might naturally be asked



whether the Central Bank will be able to eliminate it. Undoubtedly the Bank can help, but it cannot be too strongly emphasized that the efficacy of deficit financing and cheap money policies varies widely from country to country. For example, in a country like the United States, which is largely self-sufficient and so highly developed that, when labour is unemployed there is ordinarily also a large surplus of unused plant and equipment, such policies may be expected under favourable conditions to result in an increase in employment and real income without producing a serious rise in the domestic price level or a serious deficit in the balance of payments. In a country like Ceylon, however, which is very dependent upon imports, in which about half the productive resources are devoted to export, and which is chronically short of capital equipment, such policies would tend to raise domestic prices without producing an adequate response in domestic output. Instead, higher domestic incomes would stimulate the consumption of imported goods and precipitate serious balance of payments difficulties. Some figures will bring out the contrast. In the United States, of a gross national product in 1948 of more than 250 billion dollars, only 7 billion dollars was spent on imports—a ratio of imports to national product of less than 3 per cent. In Ceylon, on the other hand, of a gross national product in 1948 of approximately 2 billion rupees, imports were 985 million rupees—a ratio of imports to national income of almost 50 per cent. These figures indicate in a rather striking way why it is that in highly developed, self-sufficient countries policies such as deficit financing and expansion of private credit may be much more efficacious than they can be in under-developed countries that are largely dependent on foreign trade. This should serve as a warning to those who might hope that some of the policies growing out of Keynesian economics can be uncritically adapted to Ceylon.

Action to  
preserve  
domestic  
monetary  
stability.

63. (1) Whenever the Monetary Board anticipates economic disturbances that are likely to threaten domestic monetary stability in Ceylon or whenever abnormal movements in the money supply or in the price level are actually endangering such stability, it shall be the duty of the Board—

- (a) to adopt such policies, and to cause such remedial measures to be taken, as are appropriate in the circumstances and authorised by this Act; and
- (b) to submit to the Minister of Finance, and make public, a detailed report which shall include, as a minimum, an analysis of—
  - (i) the causes of the anticipated economic disturbances, or of the actual abnormal movements of the money supply or the price level;
  - (ii) the probable effects of such disturbances or movements on the level of production, employment, and real income in Ceylon; and
  - (iii) the measures which the Monetary Board has already taken, and the further monetary, fiscal, or administrative measures which it proposes to take or recommends for adoption by the Government.

(2) Without prejudice to the generality of the provisions of sub-section (1), it shall be the duty of the Monetary Board to submit a report in terms of paragraph (b) of that sub-section if at the end of any month the Board finds that the amount of the money supply has increased or decreased by more than fifteen per centum, or the cost of living index has increased by more than ten per centum, of its level at the end of the corresponding month in the preceding year.

(3) The Monetary Board shall continue to submit further reports periodically so long as the circumstances which occasioned the submission of the first report constitute a threat to domestic monetary stability.



## Part 2.—International Monetary Stabilization

Principles governing determination of international monetary policy.

64. In determining its international monetary policies the Monetary Board shall endeavour to maintain the par value of the Ceylon rupee and so to regulate its exchange with other currencies as to assure its free use for current international transactions.

This clause recognizes the importance to Ceylon of a stable currency and of making the Ceylon rupee freely convertible for current international transactions. In a country where almost half the national income is produced for export the significance of these objectives is self-evident.

65. (1) In order to maintain the international stability of the Ceylon rupee and to assure the greatest possible freedom of its use for current international transactions, the Monetary Board shall endeavour to maintain among the assets of the Central Bank an International Reserve adequate to meet any foreseeable deficits in the international balance of payments.

International Reserve.

(2) In judging the adequacy of the International Reserve, the Monetary Board shall be guided by estimates of the prospective receipts and payments of foreign exchange by Ceylon ; by the volume and maturity of the Central Bank's own liabilities in foreign currencies ; and, in so far as they are known or can be estimated, by the volume and maturity of the foreign exchange assets and liabilities of the Government and of banking institutions and other persons in Ceylon. So long as any part of the foreign currency assets of Ceylon are held in currencies which are not freely convertible by the Central Bank, whether directly or indirectly into gold, or are frozen, the Monetary Board shall also take this factor into account in judging the adequacy of the Central Bank's International Reserve.

In periods of deficits in the balance of payments the ability of a monetary authority to maintain the value of a currency and its free use for current international transactions depends to a very considerable degree on the volume of the country's foreign exchange resources, including both the international reserve of the authority itself and such other foreign exchange resources as it can mobilise. To illustrate, it need only be pointed out that the factor which finally forced the recent devaluation of the pound sterling was the very heavy drain on the United Kingdom's gold and United States dollar reserves.

The Central Bank of Ceylon will commence business with a very adequate international reserve of its own, and an additional reservoir of foreign exchange resources upon which it can draw in time of need. In fact, the external assets of Ceylon are now approximately 50 per cent. greater than the total money supply. Unfortunately the new Bank will have a negligible reserve in convertible currencies. The great bulk of Ceylon's external assets is in sterling which, is inconvertible and in large part blocked. The small size of the reserve in convertible currencies is not a serious problem at the moment because Ceylon is a net earner of "hard" currencies, and, through its full membership in the dollar pool, has the right to draw hard currencies if its net earnings should ever turn into net spendings. But it would not be wise to rest secure in the present state of things. Ordinary financial prudence would prompt the Monetary Board to take such action as it could to build up an independent reserve (the value of Ceylon's overseas assets fell by more than thirty per cent. in terms of gold as a result of the September devaluation), and to achieve as great a degree of independence in monetary matters as possible.

It is important therefore that every effort should be made to build up at least a nuclear reserve of gold or hard currencies, while at the same time co-operating to the fullest with the United Kingdom authorities in their efforts to achieve the free convertibility of sterling.

The Monetary Board is enjoined to endeavour to maintain "an international reserve adequate to meet any foreseeable deficits in the international balance of payments". It might be argued that this is not a sufficient guide for the Monetary



Board. Central banking legislation has traditionally prescribed a minimum ratio of a bank's international reserve to its note liabilities (or to its note and deposit liabilities together) as a check on central bank credit expansion. Experience has convincingly demonstrated, however, that a minimum reserve ratio is not a satisfactory guide to policy. At times when the actual ratio is above the legal minimum, the Bank's management may be lulled into a sense of security that is not justified by an analysis of other factors in the monetary situation; the Bank may be tempted to overexpand credit and precipitate an altogether unnecessary crisis. On the other hand, in emergencies, when the ratio is at or below the legal minimum, the contradictory nature of the requirement is clearly revealed, for it may actually make correct policy impossible. Since the Bank cannot expand its credit without violating its reserve requirement, it may be unable in such a crisis to discharge its responsibility to the commercial banks as "lender of last resort". Strict adherence to the minimum ratio "locks up" the reserve and prevents its use, just when the need may be greatest, for the very purpose for which the reserve is intended, the financing of temporary deficits in the balance of payments.

In practice minimum ratios have ordinarily been either lowered or suspended whenever they blocked, or threatened to block, central bank action. Recent Latin American legislation has introduced more refined ratios, as for example, relating the international reserve to sales of exchange over a prescribed period, but none has proved to be an adequate substitute for the sound judgment of the Central Bank's management. Australian and Philippine legislation has recognized the inadequacy of such ratios by eliminating them altogether. It is recommended that Ceylon follow this example.

Composition of  
International  
Reserve.

66. (1) The International Reserve of the Central Bank may include the following assets :—

- (i) gold ; and
- (ii) assets in foreign currencies in the form of—
  - (a) documents and instruments of types customarily employed for the international transfer of funds ;
  - or
  - (b) demand and time deposits in Central Banks, Treasuries, and commercial banks abroad ; or
  - (c) securities of foreign governments ; or
  - (d) foreign notes and coins.

(2) The Monetary Board shall endeavour to hold at least a nuclear reserve in gold or currencies freely convertible by the Central Bank, whether directly or indirectly, into gold. The Board shall particularly consider the prospects of stability and convertibility of all of the currencies in the International Reserve as well as the anticipated demand for such currencies.

Most central bank legislation strictly limits the types of international assets which may be held by central banks. For example, the Bank of Canada Act provides that, in addition to gold, the Bank of Canada may hold silver bullion and foreign exchange balances in pounds sterling, United States dollars, and freely convertible currencies. Bills of Exchange and United Kingdom and United States securities may be counted as part of the reserve if they have a maturity not exceeding 90 days. The Bank may also purchase, in any amount, securities issued by the United Kingdom, the British Dominions, the United States of America, or France, having maturities not exceeding six months from date of acquisition. It may also hold securities of the United Kingdom and the United States of America with maturities exceeding six months, but they must not exceed in value one half the paid-up capital of the Bank.

It has been considered inadvisable to limit narrowly the types of securities of foreign governments which the Central Bank of Ceylon may hold. In the beginning the Central Bank's international reserve will be more than adequate because its foreign assets will considerably exceed its total note and deposit liabilities. There appears to be no good banking reason, therefore, for not investing a portion of this reserve

in longer-term securities which bear higher interest rates, especially since a considerable portion of these assets will be blocked and not subject to withdrawal in any case. To prohibit the Bank from holding longer-term securities would mean unnecessarily sacrificing the Bank's earning capacity to excessive liquidity. Rigid restrictions would prevent the Central Bank from altering the maturity distribution of its international assets when such alteration might be justified by the country's international financial position.

It was considered similarly unwise to stipulate by law the foreign governments whose securities the Central Bank might purchase. World economic conditions change so rapidly that legislation naming individual governments might soon be out of date. In the case of the Canadian law cited above, securities of the French Government were specifically stated to be acceptable, but not long after the law was passed, the French franc began a disastrous series of devaluations which made French securities most undesirable as a form in which to hold a central bank's international assets. Accordingly this bill recognizes that it is wiser in a changing world to leave both the maturity distribution and the geographical distribution of the Central Bank's foreign assets to the discretion of the Monetary Board.

67. (1) Whenever the Monetary Board anticipates that there may develop a deficit in the international balance of payments of such magnitude as to cause a serious decline in the International Reserve, or whenever there is an imminent threat of a serious decline in the International Reserve, or whenever the International Reserve actually falls to a level which the Board considers to be a threat to the international stability of the Ceylon rupee, or whenever international payments or remittances are being made which in the opinion of the Board constitute an actual or a potential threat to such stability or are prejudicial to the national welfare, it shall be the duty of the Board—

Action to preserve the international stability of the rupee.

- (a) to adopt such policies, and to cause such remedial measures to be taken, as are appropriate to the circumstances and authorised by this Act, and
- (b) to submit to the Minister of Finance a detailed report which shall include, as a minimum, an analysis of—
  - (i) the nature, causes, and magnitude of the actual or potential threat to the international stability of the Ceylon rupee ; and
  - (ii) the measures which the Board has already taken, and the further monetary, fiscal or administrative measures which it proposes to take or recommends for adoption by the Government.

(2) The Monetary Board shall submit further periodical reports to the Minister of Finance until the threat to the international stability of the rupee has disappeared.

The purpose of this clause is to indicate in broad terms the sort of circumstances which might endanger the international stability of the rupee, and to prescribe the action which it is the duty of the Monetary Board to take in such circumstances. The ability of the Central Bank to maintain the value of the rupee by normal monetary action will depend principally upon the size of its International Reserve. Accordingly the first danger signal for the Bank will ordinarily be an actual or potential decline in the Reserve.

There might, however, be circumstances which were dangerous without any immediate threat to the Reserve being apparent. For example, it is possible to conceive of a large scale capital flight which reduced the foreign assets of savings institutions like the Post Office Savings Bank and the Ceylon Savings Bank without affecting the International Reserve of the Central Bank at all. Since such a flight would doubtless entail "international payments or remittances . . . which



in the opinion of the Board constitute an actual or potential threat to such stability " and " are prejudicial to the national welfare ", it would be the duty of the Board to take action under this section.

The first clause emphasizes anticipation, which in monetary matters is especially important because there is frequently a considerable time lag between a monetary action and its result.

With reference to the size of the International Reserve, the phrase " serious decline " has been used deliberately because it has come to be widely accepted in international usage. It has been used both in the General Agreement on Tariffs and Trade (*see* Article XII.), to which Ceylon is a party, and the Havana Charter for an International Trade Organization (*see* Article XXI.).

Alteration of  
par value of  
rupee.

68. (1) The Monetary Board may by unanimous decision recommend to the Minister of Finance the alteration of the par value of the Ceylon rupee, if the Board is of opinion that such alteration is rendered necessary in any of the following circumstances, that is to say :—

- (a) if the continuance of the existing par value hinders, or is likely to hinder unduly the achievement and maintenance of a high level of production, employment, and real income and the full development of the productive resources of Ceylon, or results, or is likely to result, in a serious decline in the International Reserve of the Central Bank or in other utilizable external assets of Ceylon, or if such a decline cannot be prevented except by—
  - (i) a large-scale increase in the external liabilities of Ceylon ; or
  - (ii) the persistent use of restrictions on the convertibility of the rupee into foreign currencies in settlement of current transactions ; or
  - (iii) undue or sustained Government assistance to one or more of the major export industries ; or
  - (iv) prolonged use of measures designed to restrict the volume of imports of essential commodities ; or
- (b) if the maintenance of the existing par value is producing, or is likely to produce, a persisting surplus in the balance of payments on current account and a monetary disequilibrium which cannot be adequately corrected by other Government action or by any Central Bank action authorised by this Act ; or
- (c) if uniform proportionate changes in the par values of the currencies of its members are made by the International Monetary Fund.

(2) Subject as hereinafter provided, no alteration of the par value of the Ceylon rupee shall be made except by Act of Parliament :

Provided, however, that, in the event of an emergency so grave or of circumstances so urgent as to require immediate action, the Governor-General may, if the Minister of Finance so advises after consultation with the Monetary Board, by order published in the *Gazette* modify the par value of the rupee.

(3) An order made by the Governor-General under sub-section (2) shall have effect for a period of ten days from the date of the publication thereof in the *Gazette* and shall then expire :

Provided, however, that if Parliament has been dissolved prior to the date of the publication of the order, the order shall have effect until the expiration of a period of ten days after the first meeting of the new Parliament, and shall then expire.



(4) Forthwith upon the expiration of an order made under subsection (2), the par value of the Ceylon rupee shall revert to the value obtaining immediately prior to the date of the publication of the order in the *Gazette*, unless provision to the contrary is made by Act of Parliament.

Clause 5 of the Bill makes the preservation of the par value of the Ceylon rupee a primary object of the Central Bank. As already indicated in the comment on that clause, it must be frankly recognized that a fundamental conflict may arise between this object and the domestic objects of the Bank which may sometimes best be resolved by a change in the par value. Clause 68 (1) describes the circumstances in which the Monetary Board may recommend such a change to the Minister of Finance. It attempts to put in more precise terms what the Articles of Agreement of the International Monetary Fund (Article IV., section 5) put thus : "A member shall not propose a change in the par value of its currency except to correct a fundamental disequilibrium."

The definition of these circumstances is by no means intended to eliminate judgment and make more or less automatic the decision to alter the par value. It is intended rather that the law should point to the key elements in any economic situation which must be appraised before a decision to revalue can be made. The Bill is silent on the question of the amount of any particular alteration. On that important yet difficult problem it has been considered impossible to furnish any legislative governing principle at all.

Paragraph (a) of sub-clause (1) envisages the circumstances which would call for a devaluation of the rupee. Ordinarily the principal evidence indicating the need for devaluation would be either an actual or threatening decline in the International Reserve of the Central Bank or in such other external assets of Ceylon as might be utilized by the Central Bank. But it is quite conceivable that devaluation would be called for even in the absence of such a decline. For example, there could be an increase in Ceylon's external liabilities on such a large scale as to prevent a decline, either as a result of foreign borrowing by the Government or the Central Bank, or as a result of an inflow of private foreign capital. The decline could also be prevented by the use of exchange control, import control, or even undue Government assistance to one or more major export industries—assistance which, though it could not be justified as a long-run measure, might temporarily maintain Ceylon's earnings from exports at a level higher than would otherwise be possible.

Paragraph (b) of sub-clause (1) envisages circumstances requiring an appreciation of the Ceylon rupee. The sort of monetary disequilibrium that might be associated with a persisting surplus in the balance of payments on current account has been somewhat more difficult to put into words. Whatever the causes of such a surplus, and there might be many, the more common effect would be an increase in the money supply associated with a rise in domestic prices. It is conceivable, however, that the increase in the money supply caused by the surplus might be counterbalanced by a capital outflow which tended to decrease the money supply. Even though the capital outflow concealed the disequilibrium in the domestic price level, it might represent so high a rate of saving in the form either of investment abroad or repatriation of foreign capital that the Monetary Board would want to retard it. The revaluation of a currency also redistributes domestic real income. For instance, a principal purpose of the New Zealand appreciation of 1948 was to shift income from certain classes of farmers who were getting high prices for their products to fixed income-groups for whom appreciation lowered the cost of living.

It may be noted in passing that in international currency experience, appreciation occurs much less frequently than devaluation because it so often requires a high order of political courage.

Paragraph (c) has been included in sub-clause (1) to provide the Monetary Board with grounds for recommending an alteration of the par value of the rupee in the event that the International Monetary Fund made uniform proportionate changes in the par values of the currencies of its members under Article IV., Section 7, of the Articles of Agreement.



The alteration of the par value of a country's currency is a prime example of a governmental act which, because of its effects on the business life of the community and the danger of precipitating capital flights, must ordinarily be discussed and decided in the first instance behind closed doors. Thus Sir Stafford Cripps announced the September devaluation while Parliament was in recess. The proviso in sub-clause (2) of this clause recognizes the necessity at times for quick and confidential decisions. Even in such emergencies, however, the Minister of Finance cannot advise the Governor-General without first consulting the Monetary Board.

While this Bill assumes that the initiative in recommending a change in the par value would ordinarily come from the Monetary Board, it is clear that the Government of the day is free at any time to alter the par value by amending the law on its own initiative.

## CHAPTER V.—INSTRUMENTS OF CENTRAL BANK ACTION

### Part 1.—Operations in Gold and Foreign Exchange

Dealings in gold.

69. The Central Bank may import, export, buy, sell, hold, or otherwise deal in gold in any form.

Foreign exchange operations of Central Bank.

70. (1) The Central Bank may engage in spot or other foreign exchange operations, that is to say, it may effect transfers of funds by telegram, letter, or other method of communication, and may buy and sell foreign notes and coins and any documents or instruments of types customarily employed for the international transfer of funds.

This sub-clause, it should be noted, authorizes the Central Bank to engage in forward exchange transactions. The commercial banks have in the past lacked facilities in Ceylon for such transactions. Since devaluation the problem of getting cover for over-bought forward positions has become especially serious and Ceylon banks have been forced to take exchange risks which really should be assumed by the monetary authority. The new Central Bank should take steps immediately to create a market in forward exchange.

(2) Foreign exchange operations may be transacted by the Central Bank only with—

- (a) commercial banks operating in Ceylon ;
- (b) the Government and agencies or institutions acting on behalf of the Government (whether established by any written law or otherwise) ;
- (c) foreign commercial or central banks ;
- (d) international financial institutions ; and
- (e) foreign governments and agencies or institutions acting on behalf of foreign governments.

The commercial banks are thus assured that in the field of foreign exchange the Central Bank will act only as a bankers' bank and banker for the Government. It will not compete with the commercial banks in dealing with the public.

Purchases and sales of foreign exchange from or to commercial banks in Ceylon.

71. (1) In order to ensure the free use of the Ceylon rupee for current international transactions, the Central Bank shall buy any quantity of foreign exchange offered, or sell any quantity of foreign exchange demanded, by any commercial bank in Ceylon :

Provided that nothing in the preceding provisions of this sub-section shall require the Central Bank to purchase foreign exchange in any currency which is not freely convertible by the Bank, whether directly or indirectly, into gold, unless there is an adequate demand, actual or anticipated, for such currency for the purpose of making payments for current international transactions, or unless the Monetary Board makes a determination that the acquisition of such currency is in the national interest.

This sub-clause should be compared with clauses 14 and 15 of the present Currency Ordinance because, like them, it provides the mechanism by which the value and the convertibility of the Ceylon rupee are to be maintained. The section differs from the Currency Ordinance sections in a number of respects.

First, the Central Bank will be required by law to maintain the convertibility of the rupee only through the medium of commercial banks in Ceylon, while the Board of Commissioners of Currency has been required to issue and redeem currency at the request of any person.

Second, whereas the Currency Board is now required to redeem Ceylon Currency with Indian rupees only, or optionally with sterling, the Central Bank will be required to sell foreign exchange in any currency demanded. This does not mean that the Bank will have to hold all of the world's currencies, from Argentine pesos to Yugoslavian dinars. It will merely hold balances in the most important international currencies and in such other currencies as are significant for Ceylon's trade. If demands are made by the banks for currencies not held by the Central Bank they can be readily met by purchases in the international currency markets such as London and New York. In actual practice, however, sterling area currencies will undoubtedly continue to be the principal currencies for financing Ceylon's international transactions.

Third, whereas the Currency Board is now required to issue Ceylon currency for Indian rupees only, or optionally for sterling, the Central Bank will be required to buy foreign exchange in any currency, provided it is freely convertible by the Bank into gold. The Bill thus makes the acquisition of inconvertible currencies a question for decision by the Board.

As long as Ceylon is a member of the sterling area and sterling is not freely convertible the implications of the second and third points are extremely important. For example, the ability of the Central Bank to meet all demands of the commercial banks for convertible currencies will depend upon the effectiveness of the Ceylon exchange control in limiting demands and upon such arrangements as the Bank or the Ceylon Government work out from time to time concerning Ceylon's contributions to and drawings upon the "dollar pool". Thus, as long as convertible currencies are accruing to Ceylon, the extent to which the Central Bank will, in effect, sell such currencies for sterling will be under this Bill a matter to be decided by the Monetary Board and the Government in terms of the national interest.

**(2) Notwithstanding anything in sub-section (1) of this section, the Monetary Board may by unanimous decision and with the approval of the Minister of Finance temporarily suspend or restrict sales of foreign exchange by the Central Bank in any case where such action is considered necessary in order to conserve the International Reserve of the Central Bank during any period of crisis affecting exchange.**

This sub-clause has been considered necessary in order to enable the Central Bank to protect its Reserve in any unforeseen crisis such as, for example, one in which sterling was permitted to "seek its own level". Some crisis might require the introduction of special legislation, and the Bank should have emergency power to protect its Reserve until the legislation is passed.

**72. (1) The Monetary Board shall determine and certify the legal parities with respect to the Ceylon rupee of foreign currencies ordinarily required for the international transactions of Ceylon. Parities so determined and certified shall be published in the *Gazette*, and shall be recognised as the legal parities for all purposes. The Monetary Board may in addition certify the parity of any foreign currency not included in the published list of parities.**

Parities of  
foreign  
currencies with  
respect to the  
rupee.

**(2) The Board may at any time desist from certifying or publishing the parity of any foreign currency if the exchange rates for that currency in international markets are unstable or widely divergent,**



(3) The legal parities of foreign currencies with respect to the Ceylon rupee shall be determined by the Board in accordance with the following provisions :—

- (a) The currency of a country which is a member of the International Monetary Fund shall have its parity with respect to the rupee established on the basis of its par value as agreed with the Fund in every case where the country is permitting exchange transactions between its currency and the currencies of other members only within the maximum and the minimum rates prescribed in the International Monetary Fund Agreement for such transactions. In any other case, or if the par value of the currency of a member country has not been agreed with the Fund, the parity of such currency with respect to the rupee may be calculated on the basis of the exchange rates for that currency in the international markets ; and if there is divergence among the rates quoted in the international markets, the Monetary Board may determine which rates to use for the determination of parity.
- (b) The currency of a country which is not a member of the International Monetary Fund shall have its parity with the rupee established on the basis of its gold equivalent, if the currency is freely convertible whether directly or indirectly, into gold. If the currency is not so convertible, its parity shall be calculated on the basis of exchange rates for that currency in the international markets ; and if there is divergence among the rates quoted in the international markets, the Monetary Board may determine which rates shall be used for the determination of parity.

Exchange rates  
for Central  
Bank  
transactions.

73. (1) The Monetary Board shall from time to time determine the rates at which the Central Bank will buy and sell foreign exchange.

(2) The rates determined under sub-section (1) for spot transactions shall not differ by more than one half of one per centum from the legal parities determined under section 72, except in the case of the rates for purchases and sales of foreign notes and coins, in which case the Board may have regard to the additional costs of, or incidental to, such transactions.

(3) The rates determined under sub-section (1) for transactions other than spot transactions shall not differ from the corresponding rates for spot transactions, except in so far as is necessary to reimburse the Bank for the additional costs, expenses, or risks of each type of transaction.

(4) The Central Bank shall not accept any commission or impose any charge of any description in respect of the purchase or sale of foreign exchange, except telegraphic or other costs actually incurred in connection with such purchase or sale.

(5) The provisions of sub-sections (2) and (3) shall not apply at any time during which the sales of foreign exchange by the Central Bank are restricted under section 71.

Loans to and  
from foreign  
institutions, &c.

74. (1) The Central Bank may grant loans to, or take loans from, any institution of any description referred to in paragraphs (c), (d) and (e) of sub-section (2) of section 70 and may engage in such other transactions with such institutions, as are expedient or desirable in the public interest and are appropriate having regard to the character of the Bank as a Central Bank.

The Central Bank may act as agent or correspondent of any such institution other than a foreign commercial bank.

(2) Any loan taken as provided in sub-section (1) may be secured by gold or other assets held by the Central Bank.

**Part 2.—Regulation of Foreign Exchange operations of  
commercial banks**

Part 2 of this chapter has been drafted with the intention that it should be self-sufficient in the absence of the existing or any future exchange control legislation. It should be regarded not as a substitution for, or an addition to, exchange control but as the permanent system for regulating the foreign exchange operations of the commercial banks. The assumption is, of course that exchange control in the sterling area, especially in Ceylon, has not become a permanent fixture, especially in the fairly rigorous and extensive form in which it is now imposed.

Since this is a monetary law, and exchange control falls within the sphere of monetary regulation, it would have been logical to have included exchange control legislation in this Bill. Such a course would have raised problems, however. Because exchange control impinges so directly upon and affects so pervasively the privacy of the general public, and involves such formidable problems of enforcement, it has been considered wiser to let it remain the ultimate responsibility of the Government rather than of an independent regulatory agency like the Central Bank. However, during and since the war many central banks have undertaken the function of operating exchange controls because they are uniquely equipped to administer it and to advise governments on control policy. Such a function ought to be regarded as a temporary and abnormal, rather than as a normal, instrument of monetary action. It has therefore been recommended to the Minister of Finance that the Central Bank assume the functions of the Ministry's present Exchange Control Department. It should do this not under the present part of this Bill, but under its authority in clause 105 (2) to act "as agent to the Government in any matter in which it is authorized so to do by the Minister of Finance after consultation with the Monetary Board".

**75. (1) The Monetary Board shall determine the minimum rate at which commercial banks may buy spot exchange and the maximum rate at which they may sell spot exchange. Where the Monetary Board has certified the legal parity of a currency in accordance with section 72, the maximum and minimum exchange rates established for such currency shall not differ from such parity by more than one per centum.**

Rates applicable to purchases and sales of exchange by commercial banks.

**(2) No commercial bank shall buy spot exchange at any rate below the minimum rate determined under sub-section (1) or sell spot exchange at any rate exceeding the maximum rate so determined ; and no commercial bank shall in respect of any purchase or sale of such exchange accept any commission or impose any charge of any description except telegraphic or other costs actually incurred in connection with such purchase or sale.**

**(3) No commercial bank shall carry out any transaction in exchange, not being a spot transaction, at any rate which differs from the rate determined under sub-section (1) for a spot transaction—**

- (a) by a margin greater than is reasonable having regard to the additional costs, expenses or risks of the transaction ; or**
- (b) by such margin, if any, as may be prescribed in that behalf by the Monetary Board.**

**(4) The preceding provisions of this section shall not apply at any time during which the sales of foreign exchange by the Central Bank are suspended or restricted under section 71.**



These provisions are in harmony with the Articles of Agreement of the International Monetary Fund, to which Ceylon has already applied for membership. Article IV, Section 3, of the Agreement says—

“The maximum and the minimum rates for exchange transactions between the currencies of members taking place within their territories shall not differ from parity—

- (i) in the case of spot exchange transactions, by more than one per cent. ; and
- (ii) in the case of other exchange transactions, by a margin which exceeds the margin for spot exchange transactions by more than the Fund considers reasonable.”

Control of  
foreign  
exchange  
holdings of  
commercial  
banks.

76. (1) In order more effectively to control the use and disposition of the foreign exchange resources of Ceylon or in order to promote the domestic investment of the resources of commercial banks, the Monetary Board may from time to time fix, or prescribe the manner of determination of, the maximum amount of the working balances which commercial banks may hold in foreign currencies generally or in any specified foreign currency or currencies and may from time to time require such banks to sell to the Central Bank all or any specified part of the surpluses in excess of such maximum amount.

(2) The Monetary Board may, having regard to the special needs of any particular commercial bank, permit that bank to hold working balances in any specified foreign currency in excess of the maximum amount fixed or determined for such currency under sub-section (1).

(3) In ascertaining whether the working balances of any commercial bank in any foreign currency are in excess of the maximum amount fixed or determined as hereinbefore provided, there may be deducted from such balances the net liabilities of that bank in currencies into which the first-mentioned currency is freely convertible.

The Exchange Control has this power at present and has set limits to the working balances in hard currencies which the banks may hold. The authority to set maximum limits to the commercial banks' working balances in foreign exchange should be made a permanent feature of the Central Bank's regulatory powers.

Requirement of  
balanced  
currency  
position.

77. (1) The Monetary Board may direct the commercial banks to maintain a balanced position between their assets and liabilities in Ceylon rupees or in any other currency or currencies in which they operate. The Board shall allow to the banks a reasonable period of time in which to adjust their currency positions to comply with any such direction.

(2) Any direction under sub-section (1) shall be made applicable to all commercial banks without discrimination :

**Provided, however, that the Monetary Board may give such a direction to any particular commercial bank in any case where, in the opinion of the Board, such action is necessary in order to protect against possible loss depositors and other creditors of the bank who are citizens of Ceylon or companies or associations controlled by citizens of Ceylon.**

The authority given to the Monetary Board under sub-clause (2) is an important means of protecting Ceylon depositors and other Ceylon creditors of the commercial banks. The strength of branches of foreign banks, for instance, is usually dependent only in small measure upon their Ceylon business. The Director of Bank Supervision might have no doubt about the soundness of the affairs of the Ceylon branch, yet have reason to doubt the strength of the head office or of the system as a whole. In such a case the Monetary Board could prohibit the Ceylon branch from investing abroad assets which in the event of liquidation would be needed to satisfy the branch's obligations to Ceylon creditors.

78. (1) Any revaluation profits realised or any revaluation losses incurred by banking institutions on their net assets or liabilities in gold or in foreign currencies freely convertible by the Central Bank, whether directly or indirectly, into gold, and arising from changes in the par value of the Ceylon rupee or in the parities or exchange rates of such currencies with respect to the Ceylon rupee, shall be assumed in their entirety by the Central Bank and shall be debited or credited accordingly.

Revaluation profits and losses on holdings of gold and foreign exchange by banking institutions.

(2) (a) If the Monetary Board so declares, the provisions of subsection (1) shall apply in relation to revaluation profits realised or revaluation losses incurred by banking institutions on their net assets or liabilities in any specified foreign currency which is not freely convertible by the Central Bank, whether directly or indirectly, into gold.

(b) Any such declaration shall have effect until it is revoked by the Board. Notice of the date on which any such declaration will be revoked shall be given to banking institutions not less than eight days before the proposed date of revocation.

(c) During the period commencing on the date of the notice referred to in paragraph (b) and ending on the date of revocation of the declaration to which it relates, every banking institution shall comply with such directions, if any, as may be given by the Monetary Board for the purpose of preventing banking institutions from increasing their holdings of the currency to which the declaration relates.

This clause is based on the principle that financial institutions should neither speculate voluntarily in foreign exchange nor be forced to incur exchange risks in the process of carrying on legitimate exchange business or foreign investment. The function of commercial banks in the field of exchange is to accept and provide foreign exchange as a service to the business community and the general public.

79. (1) Every commercial bank shall, as soon as may be after the close of business on each day make a report to the Central Bank setting out the volume and composition of its purchases and sales of foreign exchange on that day, and shall furnish such additional information as the Central Bank may require with reference to such purchases and sales and to the movements of its accounts in foreign currencies.

Information on exchange operations.

(2) The Monetary Board may also require any other person to make reports to the Central Bank at specified times or intervals as to all transactions or operations in gold, in any shape or form, and in foreign exchange.

(3) Every report under this section shall be in such of the appropriate forms as the Monetary Board may prescribe for the purpose.

(4) The Director of Bank Supervision may make such inspection or examination of the books and accounts kept by any commercial bank or other person as he may deem necessary for the purpose of verifying the accuracy of any statement set out in any report made by such commercial bank or person.

80. Whenever there is in progress an inward or outward movement of capital which in the opinion of the Monetary Board is actually endangering, or threatening to endanger, the domestic or international stability of the Ceylon rupee, it shall be the duty of the Board to take such action as is appropriate under section 63 or section 67.

Capital movements.

This clause is an explicit recognition of the fact that unsound capital movements may represent a danger to the stability of the Ceylon economy. It also makes clear that, while the Central Bank must provide foreign exchange freely for current international transactions, it is not obliged to provide foreign exchange for capital



transactions. If action under this Bill is not adequate to control unsound capital movements, the Monetary Board may recommend further action to the Government under clauses 63 and 67.

### Part 3.—Credit operations with Banking Institutions

81. (1) The Central Bank shall exercise the authority conferred by this Part of this Act to carry out the national monetary policy by regulating the supply, availability, cost, and character of credit and by providing the banking system with liquid funds in times of need.

Principles governing credit operations.

The last phrase “by providing the banking system with liquid funds in times of need” refers to the function of the Central Bank as lender of last resort.

(2) If the Monetary Board determines that it is necessary so to do by reason that, in the opinion of the Board there is in progress, or has occurred, an expansion of the money supply that represents a threat to the domestic or international monetary stability of Ceylon, the Board shall direct the suspension of the grant of credit by the Central Bank to banking institutions, except when the Board, having regard to the special circumstances, by unanimous decision approves the grant of credit.

This sub-clause attempts to ensure that in an inflationary situation the Central Bank itself will not by its credit policy contribute to the inflation. The extent and the speed with which the cessation of the Central Bank's credit operations will actually result in a contraction of Central Bank credit will depend, of course, on the size and maturity pattern of the Bank's portfolio. If in actual practice commercial banks are not heavily indebted to the Central Bank, the amount of actual credit contraction would not be great.

The provisions of this sub-clause are parallel and complementary to the provisions of clause 89 (3).

Types of operations normally authorised.

82. (1) Subject to the principles stated in the preceding section of this Act, the Central Bank may ordinarily transact with commercial banks and the Co-operative Federal Bank of Ceylon, Limited, credit operations of any description set out hereunder:—

(a) *Commercial credits.*—The Central Bank may discount, rediscount, buy and sell bills, acceptances, promissory notes, and other credit instruments with maturities of not more than 180 days from the date of their discount, rediscount, or acquisition by the Central Bank and resulting from transactions related to—

(i) the importation, exportation, purchase, or sale of readily saleable goods and products, or their transportation within Ceylon; or

(ii) the storage of non-perishable goods and products which are duly insured and deposited under conditions assuring their preservation, in authorised bonded warehouses or in other places approved by the Monetary Board.

(b) *Production credits.*—The Central Bank may discount, rediscount, buy, and sell bills, acceptances, promissory notes, and other credit instruments, having maturities of not more than 270 days from the date of their discount, rediscount, or acquisition by the Central Bank and resulting from transactions related to the production, manufacture, or processing of agricultural, animal, mineral or industrial products.

(c) *Advances*.—The Central Bank may grant loans or advances for any fixed period not exceeding 180 days upon promissory notes secured by the pledge with the Bank of—

- (i) gold coins or bullion ; or
- (ii) negotiable Treasury bills, promissory notes, debentures, bonds, or other negotiable securities of the Government ; or
- (iii) securities issued by the Central Bank itself or other credit instruments of banking institutions operating in Ceylon and approved by the Monetary Board ; or
- (iv) credit instruments referred to in paragraph (a) of this section ; or
- (v) credit instruments referred to in paragraph (b) of this section.

Notwithstanding anything in the preceding provisions of this paragraph, a loan or advance secured by the pledge of any credit instrument referred to in paragraph (b) of this section may be for a period not exceeding 270 days.

The maturities of the credit operations in which the Central Bank may engage under this clause are somewhat longer than are permitted by many central bank laws. In Ceylon, however, commercial banks confine their credit operations rather narrowly to the financing of import and export transactions. If the terms on which commercial banks may borrow from the Central Bank are reasonably liberal, they may be encouraged to lend more liberally to finance expanding domestic trade and production

(2) Except in such circumstances and subject to such conditions as the Monetary Board may determine, the Central Bank shall not grant to any commercial bank or to the Co-operative Federal Bank of Ceylon, Limited, any loan or advance upon the security of the pledge of any instrument referred to in paragraph (c) of sub-section (1) in any case where such instrument is held by such commercial bank or the Co-operative Federal Bank of Ceylon, Limited, as security for the repayment to it of the amount due upon any overdraft account.

83. Whenever, in the opinion of the Monetary Board, a deflationary situation exists which requires special relaxation of normal maturities applying to Central Bank credit operations, the Board may determine that credits may be granted by the Bank on instruments referred to in paragraph (a) or paragraph (b) of section 82 (1) having a maturity of a period longer than the period specified in those paragraphs but not exceeding one year, and may authorise loans or advances to be granted under paragraph (c) of that section for any period not exceeding one year.

Extension of maturities.

In a deflationary situation special factors may influence the liquidity pattern of the Central Bank's portfolio. At a time when the Central Bank is concerned with preventing the money supply from contracting too rapidly, it is not likely that its ability to force a rapid contraction in the immediate future will be a consideration of great importance. In such circumstances it would be sound for the Central Bank to extend the maturities of its credit operations to one year.

84. (1) In special circumstances in which the Monetary Board considers it necessary to promote or facilitate lending operations or particular classes of such operations by banking institutions which make loans upon mortgages, whether of movable or of immovable property, the Central Bank may grant loans or advances to any such institutions against promissory notes given by such institution subject to and in accordance with the following conditions :—

Loans to mortgage institutions.

- (a) that the loan or advance is repayable within a period not exceeding one year ;



- (b) that the repayment to the Central Bank of the loan or advance is secured by the assignment to the Bank by way of pledge—
    - (i) of debts falling due for payment within the same period to the institution by its borrowers, and
    - (ii) of the mortgages given as security for the payment of such debts to the institution ;
  - (c) that the borrowers from whom such debts are due to the institution are not in default or arrears ; and
  - (d) that the total amount of the loan or advance by the Central Bank must not exceed fifty per centum of the total amount of the debts which are so assigned to it.
- (2) The Central Bank may make advances to any institution referred to in sub-section (1) upon the terms and conditions mentioned in section 82 (1).
- (3) Loans or advances shall not be made under sub-section (1) by the Central Bank at any time when the Board is of opinion that the grant thereof would cause or aggravate inflationary tendencies.

A central bank should not ordinarily extend credit to long-term lending institutions, and the short-term credit needs of such institutions can usually be met by the commercial banks. Nevertheless, there may be times when some assistance by the Central Bank to mortgage-lending institutions would be advantageous and appropriate.

Emergency  
loans and  
advances.

85. (1) In periods of emergency or of imminent financial panic which directly threaten monetary and banking stability, the Central Bank may grant to banking institutions extraordinary loans or advances secured by any assets which are defined as acceptable for the purpose by the Monetary Board by unanimous decision.

The purpose of this sub-clause is to enable the Central Bank to fulfil its function as lender of last resort in financial crises.

(2) A banking institution to which an extraordinary loan or advance is granted under sub-section (1) shall not, while the loan or advance is outstanding, expand the total volume of its loans and investments except with the prior approval of the Monetary Board.

Interest and  
discount rates.

86. The Monetary Board shall fix the interest and discount rates to be charged by the Central Bank on its credit operations in accordance with the character and term of each such operation ; and the Board shall, in so doing, have regard to the soundness of credit conditions, the needs of the market, and the general requirements of the national monetary policy.

Since the Central Bank will not be required to publish a single discount rate, the Monetary Board, by fixing different rates for different categories of credit operations, may be able to encourage types of lending by commercial banks which will best promote the full development of the economic resources of Ceylon, and to discourage those which will not.

General  
conditions as  
to grant to  
credit facilities.

87. The Monetary Board may prescribe the conditions subject to which credit facilities of the Central Bank will be available to banking institutions, including conditions relating to the rates of interest charged by such institutions, to the purposes for which their loans in general are destined, and to any other matter affecting or connected with the credit policy of such institutions.

#### Part 4.—Credit Operations with the Government

Provisional  
advances to  
the Government.

88. The Central Bank may make direct provisional advances to the Government to finance expenditures authorised to be incurred out of the Consolidated Fund :

Provided that every such advance shall be repayable within a period not exceeding six months and the total amount of such advances outstanding at any time shall not exceed ten per centum of the estimated revenue of the Government for the financial year in which they are made.

Many central banks and national economies have come to grief because Governments have had too easy access to central bank credit. In Ceylon it has been considered wise, at least while the Central Bank is new, to limit the direct access of the Government to Central Bank credit to its short-term, seasonal requirements for funds.

#### Part 5.—Open-Market Operations

89. (1) The Central Bank shall so exercise the authority conferred by this part of this Act to conduct open-market operations as to secure any of the following purposes, that is to say :—

Principles governing open-market operations.

- (a) to increase the liquidity or stabilise the values of the securities referred to in section 90 in order thereby to promote private investment in such securities ; and to prevent or moderate sharp fluctuations in the quotations of such securities so, however, as not to alter fundamentally movements in the market resulting from basic changes in the pattern or level of interest rates ;
- (b) to increase or decrease the supply and availability of money in accordance with the national monetary policy as determined by the Monetary Board.

Although open-market operations in Government securities have long been a principal instrument of action of the world's more mature and better established central banks, it is not the sort of instrument that can readily and quickly be adapted to a country like Ceylon. The market in securities in Ceylon is as yet so small that purchases or sales by the Central Bank on any considerable scale would cause wide variations in their prices.

Although open-market operations may be of limited usefulness in Ceylon it is well that the Bank should have the authority to engage in them, so that it can make of them whatever use it can.

The market for securities in Ceylon is small because the country is small and the flow of savings available for investment is small. Apart from these inescapable limitations, the market has been handicapped because potential investors have been fearful of its stability and liquidity and because the maturity pattern of Government securities available to investors has been incomplete. There have been no offerings between 90-day Treasury Bills on the one hand and long-term securities on the other. The initial tasks of the Central Bank, therefore, will be to try to broaden and stabilize the market by preventing or moderating sharp fluctuations in the quotations of securities and to advise the Government with respect to a maturity pattern for its new issues that will be more attractive to investors. If a broad enough market can be established, the Bank will be able to use open-market operations for the purpose of affecting the volume of commercial bank reserves and the money supply.

(2) In conducting open-market operations in Government securities, the Central Bank shall have regard to the need for maintaining adequate holdings of short-term securities in order to enable the Bank more readily to contract its credit if such contraction becomes necessary.

This sub-clause merely puts into words the injunction familiar to central bankers and commercial bankers alike that a bank should look to the liquidity of its portfolio.

(3) If the Monetary Board determines that it is necessary so to do by reason that, in the opinion of the Board, there is in progress, or has



occurred, an expansion of the money supply or of bank reserves that represents a threat to the domestic or international monetary stability of Ceylon, the Board shall take action to secure—

- (a) that purchases of rupee securities in the open market by the Central Bank are suspended, except in special circumstances where the Board by unanimous decision determines that such purchases are necessary in the public interest ; and
- (b) that sales of rupee securities are transacted in the open market by the Bank to such extent as market conditions permit.

This sub-clause, like sub-clause 89 (2), is designed to prevent the Central Bank in an inflationary situation from itself contributing to the inflation.

Authority of  
Central Bank to  
transact  
open-market  
operations.

**90. (1) In order to carry out the purposes of this Part the Central Bank is hereby authorised—**

- (a) to purchase and sell securities issued by the Government or securities fully guaranteed by the Government ; and
- (b) to issue, place, buy, and sell freely negotiable securities of the bank itself.

The principal use of open-market operations would ordinarily be to offset the effects of surpluses and deficits in the balance of payments. During a surplus period, for example, the Bank would be expanding its assets, and therefore its note and deposit liabilities, through the purchase of gold and foreign exchange from the banking system. The obvious way to offset an increase in the foreign exchange assets of the Central Bank is by a reduction of its domestic assets, and these are likely to consist principally of Government securities, which would have to be sold in the market. If the Bank's portfolio of such securities is small, or if its holdings do not have the maturities or other characteristics desired by the market, the Bank has the alternative of issuing its own freely negotiable securities. As indicated in clause 91, the Monetary Board may exercise discretion in fixing the characteristics of such securities. In order to make them more attractive to investors, for instance, it might issue them against specific categories of its assets, such as against Government securities or even the gold or foreign exchange in its International Reserve.

This authority to issue its own obligations supplies a weapon that is missing from the armoury of most other central banks. Thus, the Central Bank of Ceylon need not be concerned about ever being in a situation calling for open-market sales without having anything to sell.

**(2) The power conferred on the Central Bank by the preceding provisions of this section shall be deemed to include the power to purchase and sell Government securities which are denominated in foreign currencies.**

Conditions as  
to issue of  
securities by  
Central Bank.

**91. (1) Securities issued by the Central Bank shall be on such terms and conditions and in such form as may be determined by the Monetary Board.**

It should be pointed out that the Bank's own obligations are issued not for profit, but in the national interest, for the purpose of stabilizing prices. Since the cost of issuing and paying interest on these obligations are extraordinary and would adversely affect the Bank's profits, clause 40 provides for gradual amortization.

**(2) Any security issued by the Central Bank which is purchased or redeemed by the Bank shall not be included among its assets and shall be immediately retired and cancelled.**

Before proceeding to the next part, reference should be made to an important problem of central banks the world over. It is extremely difficult for central bank legislation to draw a line separating open-market purchases of Government securities made for sound monetary reasons from purchases which are really no more than an



indirect means of making central bank credit available to finance Government deficits. Although the line may be somewhat artificial, this Bill has attempted to draw it. The Bill limits narrowly the Central Bank's authority to make direct advances to Government (clause 88), prohibits the bank from subscribing to new issues (clause 111), and authorises open-market operations only for purposes of assuring the liquidity and stability of the market and of increasing or decreasing the supply and availability of money in accordance with the national monetary policy (clause 89). These limitations are intended to take the place of the existing limitations in the Currency Ordinance on the purchase of Ceylon Government securities by the Board of Commissioners of Currency.

It must be recognized, however, that if the Government were determined, even in the face of opposition by the Monetary Board, to make excessive use of Central Bank credit, legal limitations could be relaxed and the Board being a Government agency, would have no alternative but to comply. These considerations apply also to the Currency Ordinance.

The danger that a government will make use of the power of a central bank to over-expand credit is a real one, and might appear a strong argument against having a central bank at all. But, as already stated, if a government wishes to engage in the irresponsible creation of money, it can do so without a central bank. Paper money has come to stay. The only real safeguard against its abuse is responsible government.

#### Part 6.—Regulation of the Reserves of Commercial Banks

92. (1) The Monetary Board shall, in order to limit the volume of money created by the credit operations of the banking system, require commercial banks operating in Ceylon to maintain reserves against their deposit liabilities, and shall for such purpose define the classes of deposit liabilities against which reserves shall be held.

Reserve requirements.

(2) The reserves required to be held by any commercial bank shall be proportional to the volume of its deposit liabilities and shall ordinarily take the form of rupee deposits in the Central Bank :

Provided that the Monetary Board may in its discretion permit the maintenance of any part of the required reserves in the form of assets, other than rupee deposits in the Central Bank.

93. (1) The Monetary Board shall prescribe, and may from time to time modify, the reserve ratios applicable to each class of rupee deposits. The ratios so prescribed shall not be less than five per centum or more than twenty per centum in the case of time and savings deposits, and shall not be less than ten per centum or more than forty per centum in the case of demand deposits and unused balances of overdrafts allowed.

Monetary Board to prescribe reserve ratios.

(2) Any increase of the reserve ratio which is to be applicable in respect of any existing liability shall be made by the Board in a gradual manner and shall not exceed four percentage points in any one period of thirty days. The Board shall, except in extraordinary circumstances endeavour to give the commercial banks at least fourteen days' notice of the date on which any such increase is to become effective.

The original purpose of reserve requirements was to safeguard the liquidity of the commercial banks by ensuring that each bank retained sufficient cash to meet the demands of its depositors. In a modern monetary system this function of safeguarding the liquidity of the banks is performed by the Central Bank, acting as lender of last resort. Reserve requirements are still important, however, for the purpose mentioned in clause 92 (1)—“to limit the volume of money created by the credit operations of the banking system.”

In Ceylon where the capital market is so small that the traditional instruments of central bank action, the discount rate and open-market operations, cannot be so effective as in highly developed countries, a system of flexible reserve requirements is likely to be the Central Bank's most useful and most effective means of credit control.



During a period of inflow of gold or foreign exchange, the Monetary Board can, if it thinks it necessary, raise reserve requirements and in this way limit the extent to which an increase in commercial bank reserves can be used by the banks to expand their credit. In fact, with the special authority given to it under clause 94 (1) the Monetary Board can in periods of serious inflation raise reserve requirements on future increases in deposits so as to eliminate completely the possibility of any additional expansion of bank credit.

A major difficulty with the reserve requirement mechanism is that it is more effective in checking an unsound, than in stimulating a sound, expansion (or preventing an excessive contraction) of bank credit. A raising of reserve requirements can eliminate the excess reserves that make an expansion possible, but a lowering of reserve requirements, though it produces excess reserves, cannot force the banks to use them. It was once believed that the profit motive would always stimulate commercial banks to expand credit and quickly eliminate excess reserves from the banking system. Events since 1930, however, have demonstrated clearly, both in developed and underdeveloped countries, that excess reserves can become virtually chronic.

It is impossible to predict the reaction of the banks in Ceylon to the existence of excess reserves. In the absence of a central bank in the past, commercial banks have had in effect to be their own central banks, so that they have customarily held much higher cash ratios than are usually held in systems where central bank facilities are available. The five per cent. statutory minimum reserve against demand liabilities contained in the Companies Ordinance has been far below the reserves held in actual practice.

As is well known, all but one of the major commercial banks in Ceylon are branches of foreign banks depending for their profits principally upon a rapid turnover in the exchange business of a relatively small proportion of their total funds. Indeed, as evidence of their primary interest they have called themselves "exchange banks". The nature of their business has been such that they could operate at a profit without building up a large domestic banking business. These banks have expanded their domestic banking business considerably since 1934, when the Report of the Banking Commission was written, but more could be done.

Another reason for uncertainty about the effect on the banks of the existence of excess reserves is the impossibility of predicting their attitude towards being indebted to the Central Bank. It is unfortunate from the point of view of central bank control that in many countries indebtedness of commercial banks to the central bank is regarded in the banking community as a sign of weakness. In Ceylon the cash positions of banks financing foreign trade are subject to spasmodic fluctuations due to seasonal and other shifts in the flow of import and export bills. If the reluctance to borrow from the Central Bank should prove to be strong in Ceylon, banks may wish to hold a margin of reserves above the required minimum set by the Monetary Board sufficient to enable them to avoid borrowing from the Central Bank. Branches of foreign banks also have the alternative, of course, if they so choose, of borrowing from their head offices or from other branches in preference to borrowing from the Central Bank.

Although these uncertainties exist, it is nevertheless a principal aim of this legislation to stimulate the banks, through the introduction of a central bank, to use their excess reserves to meet the growing volume of legitimate credit needs of Ceylonese business. As a corollary of this aim, the Central Bank should endeavour to encourage the spread of the banking habit and the extension of banking facilities in Ceylon as rapidly as is consistent with sound banking.

This bill has been drawn up on the assumption that these goals can be achieved best by private enterprise with no greater degree of assistance in the form of State aid than has been given in the past. For that reason the bill makes the Central Bank entirely a bankers' bank. It will not compete with the existing commercial banks in any way for the business of the public. If this confidence in the rapid growth of private banking in Ceylon proves warranted, there should be no need to experiment with combining the functions of central and commercial banking in a single institution, as has been tried in a few instances elsewhere.



94. (1) Notwithstanding anything in section 93, the Monetary Board may, during periods of inflation or when inflation is anticipated prescribe reserve ratios not exceeding one hundred per centum of the amount by which the rupee deposits of any class in any commercial bank may, after the date on which notice is given to that bank of the fixing of the new reserve ratio, exceed the amount of such deposits which were in that bank on that date.

Fixing of special high ratios in time of inflation.

(2) In any case where any commercial bank is required, by reason of the exercise of the powers conferred on the Monetary Board by sub-section (1), to maintain a minimum reserve against any class of rupee deposits of an amount exceeding the maximum amount specified in section 93 (1) for that class of rupee deposits, the Central Bank shall pay to that bank interest on the amount in excess at a rate not higher than the Central Bank's lowest discount rate for the time being in operation.

The authority to fix special high ratios is the sort of standby authority which a central bank needs for use in critical periods when there is a large and rapid increase in bank reserves, whether due to a surplus in the balance of payments or other cause. The Australian special accounts system is similar in principle to a system of special high ratios and was successful as an anti-inflationary measure during the last war so much so, in fact, that the system has been permanently incorporated into central banking practice in Australia by the Bank Act of 1945.

The system provided by this clause is fully as effective as the special accounts system but has been chosen in preference to the latter because it is a simple extension of the flexible reserve requirements contained in clauses 92 and 93, and because there is no room for arbitrary discrimination in its administration ; it must be applied to all banks uniformly.

95. The reserve position of each commercial bank shall be calculated daily on the basis of the amount, at the close of business for the day, of the reserves actually held by that bank and the amount of its liability accounts against which reserves are required to be maintained.

Computation of reserve position.

In the computation of the reserve position of a commercial bank its principal office in Ceylon and all its branches and agencies in Ceylon shall be considered together as one unit.

96. (1) Whenever the reserve position of any commercial bank computed in the manner provided in section 95 is below the required minimum, the bank shall pay to the Central Bank interest at the rate of one-tenth of one per centum per day on the amount of the deficiency :

Consequences of reserve deficiencies.

Provided, however, that the Board may, if it thinks fit to do, permit any commercial bank to offset any reserve deficiency occurring on one or more days of any week with any excess reserves which it may hold on other days of the same week ; and in any such case the bank shall be required to pay interest only on the average daily deficiency, if any, for that week.

(2) In any case where any bank fails more or less continuously to maintain the required minimum reserve, the Monetary Board may make order—

- (a) prohibiting or restricting the making of new loans or investments by that bank ; and
- (b) prohibiting the application of the whole or any specified part of the net profits of that bank for the purpose of the payment of a dividend to its shareholders.

97. (1) The Central Bank shall provide facilities for clearance transactions among commercial banks operating in Ceylon.

Clearance and settlement.



(2) The deposit reserves maintained by commercial banks in the Central Bank under the preceding provisions of this Part shall serve as a basis for the clearance of cheques and the settlement of balances among such banks in accordance with such rules as may be made in that behalf by the Monetary Board.

Under the provisions of this section the Central Bank should endeavour to set up a system of inter-bank clearing under which cheques will be cleared quickly at par anywhere in the Island. Such a system is essential to the development of the banking habit in Ceylon.

#### **Part 7.—Additional Regulation of Credit Operations of Banking Institutions**

The clauses in this Part of the Bill consist of various miscellaneous regulations for which central banks elsewhere have found important uses. They are all permissive rather than obligatory in character, and several are intended for use in special situations rather than as customary controls. Some of them are recent developments in central banking practice growing out of recent experiences with inflations.

The emphasis is upon selective rather than quantitative regulation of bank credit. In other words, by use of the following powers the Monetary Board can discourage or even prohibit the use of bank credit for purposes prejudicial to the public interest and encourage its use for purposes which promote the public interest.

The non-discriminatory powers granted to the Monetary Board under this Part are considered to be preferable to section 21 of the Banking Companies Act, 1949, in India, which is intended to accomplish some of the same objectives.

Principles governing additional regulations.

98. The powers conferred on the Monetary Board by this Part of this Act shall be so exercised as to regulate the supply, availability, cost and character of bank credit in accordance with the national monetary policy as determined by the Board, and to ensure that bank credit is not granted for speculative purposes or other purposes prejudicial to the public interest.

Maturities of Bank loans and security therefor.

99. The Monetary Board may from time to time by order prescribe the maximum permissible maturities for loans and investments made by commercial banks after the order comes into force and the nature and amount of the security to be permitted or required for various types of credit operations.

The authority granted the Monetary Board by this clause is not intended to be used to interfere with the customary or normal loans and advances made by banks in Ceylon. It should not be used to hamper sound banking, but should be reserved for stopping abuses that may arise in the form of unsound loans or the speculative use of bank credit.

Limitation of loans and investments of commercial banks.

100. (1) The Monetary Board may from time to time by order—

- (a) prohibit commercial banks from increasing the amount of their loans and investments ; or
- (b) fix limits to the rate at which the amount of loans and investments may be increased within specified periods :

Provided, however, that nothing in any such order shall be deemed to require any commercial bank to reduce the amount of its loans and investments below the amount outstanding at the date of the order.

(2) An order under sub-section (1) may be made applicable to all the loans and investments of each commercial bank or any specified class or classes of such loans and investments, so however, that every such order shall be applicable to all banks uniformly and without discrimination.



Under this clause the Monetary Board may fix what are known as "portfolio ceilings", either ceilings on loans and investments as a whole or ceilings on any particular category or categories of loans and investments. It is primarily an anti-inflationary regulation and should ordinarily be used only for such purpose. It might be used selectively, however, to prevent or slow the increase of a particular type of credit expansion which the Monetary Board regarded as speculative or otherwise prejudicial to the public interest.

**101. The Monetary Board may from time to time by order prescribe the minimum ratios which the capital and surplus of commercial banks shall bear to the total volume of their assets or to any specified categories of such assets.** Minimum Capital ratios.

Minimum capital ratios, or "capital-asset ratios", as they are sometimes called, have been introduced in some of the Latin American countries in recent years. They can serve three purposes.

The first purpose is to preserve the solvency of banks and thereby protect depositors and other creditors against loss. The underlying principle is that the capital and surplus of a bank should be related to the volume of the bank's risk-bearing assets. Thus, if a bank's assets consisted entirely of cash and Government securities, which were virtually riskless, there would be no need for any capital, as depositors would be fully covered. But if a bank has risk-bearing assets, at least a proportion of the amount so invested should be supplied by the stockholders, and the riskier the assets the higher the proportion the stockholders should supply. Thus, for example, capital and surplus might justifiably be required to be equal to, say, 40 or 50 per cent. of the real estate and other fixed assets of the Bank but to only 5 per cent. of its high grade commercial loans. Any such percentages should be additive.

The second purpose of capital asset ratios is to serve as an instrument of quantitative credit control. As such it is supplementary to the reserve ratios provided for in Part 6 of this chapter of the Bill.

The third purpose is to serve as an instrument of selective credit control. For example, the Monetary Board might establish high ratios of capital and surplus to types of loans which it wished to discourage and low ratios to types it wished to encourage. Such ratios would, of course, have to be consistent with the risk principle underlying the use of the ratios to ensure the solvency of the banks.

A problem arises in applying this regulation in a country like Ceylon where so many of the banks are branches of foreign institutions and have no assigned capital as such in the country. This problem will have to be carefully studied by the Monetary Board before minimum capital ratios are prescribed.

**102. The Monetary Board may by order direct that letters of credit shall not be opened by commercial banks unless such letters are covered by minimum cash margins of such amount or proportion as may be prescribed by the Board ; different cash margins may be so prescribed for different classes of transactions to be financed by means of letters of credit.** Margin requirements against letters of credit.

In an importing country like Ceylon this regulation can be an effective means of preventing the use of bank credit for the importation of goods which are not necessary for the general welfare of the people. The regulation might be used particularly to require high margins for the opening of letters of credit to finance the importation of luxury or other non-essential goods. It might also be used to discourage the speculative importation of commodities which happen at the moment to be in short supply. Obviously this regulation should be co-ordinated closely with ordinary import control.

**103. (1) The Monetary Board may from time to time make order—** Fixing of interest rates, commissions and charges.  
**(a) fixing the maximum rates of interest which commercial banks may pay upon various classes of deposits ; or**



(b) fixing the maximum rates of interest which commercial banks may charge for different types of loans or other credit operations.

(2) Subject as hereinafter provided, the maximum rate of interest fixed by order under sub-section (1) shall apply in relation to any deposit, or to any loan or credit operation, as the case may be, completed before the date on which the order comes into force :

Provided, however, that nothing in any such order—

(a) shall apply in relation to any interest accrued before that date ; or

(b) shall require or be deemed to require the reduction of the rate of interest payable upon any deposit completed before that date if such reduction would constitute a breach of the contract or agreement relating to such deposit.

(3) For the purposes of preventing evasion of any order made under sub-section (1), the Monetary Board may from time to time prescribe the maximum rates which may be paid to or charged by commercial banks in the form of commissions, discounts, fees or other payments whatsoever.

Control of interest rates is common in many countries. This control, again, is necessary only to prevent abuses, such as unsound competition for deposits among banks in the form of payment of excessively high rates of interest on time and savings deposits or of payment of interest on demand deposits.

Conditions of eligibility of credit instruments for discount, &c. by Central Bank.

104. The Monetary Board may declare that credit instruments held by banking institutions will not be accepted for discount or rediscount by or advances from the Central Bank, if the interest rates charged by such institutions in respect of the loans or other credit operations to which such instruments relate exceed the interest or rediscount rates of the Central Bank by more than such percentage or margin as may from time to time be prescribed by the Board.

#### CHAPTER VI.—THE CENTRAL BANK AS FISCAL AGENT, BANKER, AND FINANCIAL ADVISER OF THE GOVERNMENT

Central Bank to be fiscal agent and banker of the Government.

105. (1) The Central Bank shall act as the fiscal agent and banker of the Government and of agencies or institutions acting on behalf of the Government, whether established by any written law or otherwise.

This sub-clause refers to the usual fiscal agency and banker functions performed by a central bank for a government.

(2) The Central Bank may, in addition to exercising the functions mentioned in sub-section (1), act as agent of the Government for the purposes of any matter or transaction if it is authorised so to do by the Minister of Finance after consultation with the Monetary Board.

This sub-clause authorizes the Central Bank to act as agent for the Government in any matter or transaction in which it is not authorized to act by provisions elsewhere in the Bill. It is to be expected that functions assumed by the Bank under this authority would be by agreement between the Minister of Finance and the Monetary Board.

Official depository of the Government.

106. (1) The Central Bank shall be the official depository of the Government and of agencies or institutions referred to in sub-section (1) of section 105 :

Provided, however, that the Monetary Board may authorise one or more commercial banks operating in Ceylon to accept Government deposits, subject to such rules and regulations as the Board may prescribe.

The Central Bank should carry the principal accounts of the Government. This does not mean, however, that commercial banks operating in Ceylon may not also carry Government accounts.

**(2) The Monetary Board shall advise the Government regarding the distribution of official deposits between the Central Bank and commercial banks and the effects of such distribution on monetary conditions in Ceylon.**

The significance of this sub-clause is that a transfer of Government funds from the Central Bank to the commercial banks increases the reserves of the commercial banks and might enable them to expand credit, whereas a transfer in the opposite direction would decrease their reserves and might force them to contract credit. The Government should, on the advice of the Monetary Board, take this factor into account in determining the distribution of its deposits between the Central Bank and the commercial banks.

**(3) The Bank shall not pay interest on deposits of the Government or of agencies or institutions referred to in sub-section (1).**

**107. The Central Bank may act as agent, or for the account, of the Government or of any of the agencies or institutions referred to in sub-section (1) of section 105, in guaranteeing, insuring, or participating in the loans, or any category thereof, of banking institutions operating in Ceylon.**

Loan guarantees  
and loan  
insurance.

It has already been pointed out in the comment on clause 93 that the existence of a central bank may increase the readiness of the banks to finance the growing volume of the legitimate needs of Ceylonese business. It must be recognized, however, that there are many unusual risks of lending in Ceylon. Sometimes the businessmen seeking loans are newcomers who have not satisfactorily established their credit or who are not able to offer satisfactory security to the commercial banks. Everything possible within the scope of sound finance should be done to encourage the development of new productive and commercial enterprises in Ceylon. In other countries unusual risks have sometimes been found to be insurable. To the extent that they are so, it would be possible for many loans to be made which the banks could not otherwise afford to consider.

In the field of mortgage lending defective titles are a major obstacle to the making of sound loans. These risks, too, are believed to be to some extent insurable.

Special legislation will be required, however, for any systems of insuring or guaranteeing loans. This clause is based on the belief that the Central Bank is clearly the best institution to act as agent of the Government in administering any such systems that might be established.

**108. In the performance of its functions as fiscal agent and banker of the Government, the Central Bank may engage the services of banks or other institutions in places, whether in Ceylon or abroad, where the Central Bank does not have offices or agencies adequately equipped to perform such functions.**

Other  
institutions as  
agents of  
Central Bank.

**109. The Central Bank shall not ordinarily collect any commissions fees, or other charges for services which it renders to the Government or to any agencies or institutions referred to in sub-section (1) of section 105 :**

Remuneration  
for services.

Provided, however, that the Monetary Board may, in special cases, conclude an agreement with the Minister of Finance providing for reimbursement for services the cost of which the Bank is unable to bear.

Since the Central Bank is to be a Government institution, whose relations with the Government will be far more complex than the relations of an ordinary bank with its client, there is no clear economic justification for having the Central Bank pay interest on Government deposits (*see* clause 106 (3)), pay taxes (*see* clause 117), or collect



charges for the customary services that it renders the Government. Profits ultimately go to the Government, in any case ; and as the earnings of the Bank are likely to be substantial, the Bank itself should be able to meet the cost of its ordinary services to the Government. It has, however, been considered necessary to provide that in special circumstances (as, for example, when the Bank in its capacity as agent for the Government handles costly operations) the Government may reimburse the Bank for its services.

Representation  
with foreign  
governments,  
agencies, and  
international  
institutions.

110. The Central Bank may represent the Government of Ceylon in any dealings, negotiations, or transactions with the International Monetary Fund and shall carry such accounts as may result from Ceylon's membership in, or operations with, the Fund. The Central Bank may also be authorised by the Government to represent it in dealings, negotiations, and transactions with foreign governments, institutions, or agencies, or with the International Bank for Reconstruction and Development or other international financial institutions and agencies.

Issue of  
Government  
securities.

111. The issue of securities of the Government or of any of the agencies or institutions referred to in sub-section (1) of section 105 shall be made through the Central Bank, which shall act as agent, and for the account, of the Government or of such agency or institution :

Provided, however, that except in the case of Treasury bills, for which the Central Bank may make direct tenders, the Bank shall not subscribe to any issue of such securities or agree to purchase the unsubscribed portion of any such issue.

Many central banks have the authority to underwrite domestic issues of Government securities, and in some instances central banks have underwritten issues floated in foreign markets. In the underwriting of domestic issues there are obvious possibilities of abuse, so that it is recommended that in Ceylon the Central Bank should not have this authority until central banking traditions and conventions have become well established.

Management of  
the public debt.

112. The Central Bank shall, as agent of the Government, be responsible for the management of the public debt.

Advice on  
Government  
credit  
operations.

113. No new loan shall be raised and no new issue of stock or debentures shall be made by the Government or by any agency or institution referred to in sub-section (1) of section 105, whether in pursuance of authority conferred by any written law or otherwise, unless the advice of the Monetary Board has first been obtained upon the monetary implications of the proposed loan or issue.

Recommend-  
ations as to  
policy, &c. of  
Government  
agencies or  
institutions.

114. The Monetary Board may from time to time make recommendations to the Minister of Finance or to any agency or institution referred to in sub-section (1) of section 105, as to the measures and policies which should be adopted by such agency or institution for the purposes of co-ordinating its policy with the policies of the Board ; and where any such recommendations are made to the Minister, the Minister or any other authority or person may, if empowered so to do by any such other written law as may be applicable, make or issue such orders or directions or take such other action as may be necessary for the purpose of giving effect to such recommendations.

In a small country like Ceylon it is clearly advantageous to place the responsibility for co-ordinating the activities of all Government credit institutions in the Monetary Board of the Central Bank. The Board determines monetary and credit policy in general and should have some means of ensuring that the policies of other credit institutions conform.

The Board should be able to co-ordinate both the borrowing and the lending and investment operations of such institutions. With respect to borrowing, co-ordination



is necessary in order to prevent separate Government agencies from competing with each other and "spoiling" the market, especially in the early stages of its development, and to make possible the formulation of a properly diversified pattern of interest rates and maturities for the entire Government borrowing program. With respect to lending and investment, co-ordination is in some respects even more important. There is some unfortunate overlapping and duplication of functions by existing lending agencies, yet certain fields of domestic lending and investment are covered inadequately if at all. In the public interest the Monetary Board should be responsible for seeing that such defects are remedied. Perhaps even more important with respect to investment, however, is the fact that institutions like the Post Office Savings Bank, the Ceylon Savings Bank, and the Loan Board hold large quantities of sterling and Indian rupee securities. Such holdings are a significant part of the external assets of Ceylon and an important supplement to the International Reserve of the Central Bank. It is clearly the duty of the Monetary Board to formulate policy and advise the Government with respect to them.

115. On or before the fifteenth day of May in each year the Monetary Board shall submit to the Minister of Finance for use in preparation of the Budget speech a confidential report describing and analysing the monetary situation in Ceylon and the current monetary policy of the Board, and examining the effect of the current fiscal policy of the Government upon the ability of the Central Bank to achieve the objects specified in section 5.

Annual Report on applications of Government's fiscal policy.

## CHAPTER VII.—GENERAL

116. Save as otherwise expressly provided in this Act, the Central Bank shall not—

Business which Central Bank may not transact.

- (a) engage in trade or otherwise have a direct interest in any commercial, industrial, or other undertaking except such interest as it may in any way acquire in the course of the satisfaction of any of its claims : Provided that all such interests shall be disposed of at the earliest possible opportunity ; or
- (b) purchase the shares of any other banking institution or of any company, or grant loans or advances upon the security of any such shares ; or
- (c) grant loans or advances on the mortgage of, or otherwise on the security of, immovable property or documents of title relating thereto.

117. Notwithstanding anything in any other written law—

- (a) the Monetary Board shall be exempt from the payment of income tax and profits tax upon the income or profits of the Central Bank ;
- (b) all immovable property owned by the Board and occupied for the purposes of the Central Bank shall be exempt from the payment of any property rates and other rates imposed by any local authority ;
- (c) all goods of any description imported or purchased out of bond by the Board for the purposes of the Central Bank shall be exempt from customs duty ; and
- (d) the Monetary Board shall be exempt from the payment of stamp duty on any instrument executed by, or on behalf of, or in favour of the Monetary Board or the Central Bank in cases where, but for this exemption, the Monetary Board would be liable to pay the duty chargeable in respect of such instrument.

Exemption from income tax, rates, import duty, and stamp duty.



Acts of Monetary Board valid notwithstanding subsequent discovery of disqualification.

Officers and servants to be deemed public servants for purposes of Chapter IX of Penal Code, Cap. 15.

Protection for banking institutions.

Offences and penalties.

Offences by corporations.

Exclusion of application of Ordinance No. 51 of 1938.

Provision for conflict with other written law.

118. All acts done at any meeting of the Monetary Board shall, notwithstanding that it shall afterwards be discovered that there was some defect in the appointment of any member thereof or that any such member was disqualified, be as valid as if every such member had been duly appointed and duly qualified.

119. Every member of the Monetary Board and every officer or servant of the Central Bank shall be deemed to be a public servant within the meaning and for the purposes of Chapter IX of the Penal Code.

120. Notwithstanding anything in any written or other law, no banking institution shall be liable or subject to any action or proceeding in any court in respect of any loss or damage suffered or incurred or alleged to have been suffered or incurred by any person by reason of any act or thing done or omitted to be done by such institution for the purpose of carrying out or complying with any provision of this Act or any rule, regulation, order, direction or requirement made or given under this Act.

121. (1) Any person who contravenes or fails to comply with any provisions of this Act or any rule, regulation, order, direction or requirement made or given thereunder shall be guilty of an offence under this Act.

(2) Every person who is guilty of an offence by reason of the contravention of or failure to comply with section 30, or section 32 (2), or section 45 or section 46 or section 50 or any rule, regulation order, direction or requirement made or given under section 30, or section 78 (2) (c), or section 100 or section 101 shall be liable—

(a) on conviction after summary trial before a Magistrate to imprisonment of either description for a term not exceeding six months or to a fine not exceeding two thousand five hundred rupees, or to both such imprisonment and such fine ; or

(b) on conviction before a District Court to imprisonment of either description for a term not exceeding three years or to a fine not exceeding ten thousand rupees, or to both such imprisonment and such fine.

(3) Every person who is guilty of an offence for which no punishment is prescribed by sub-section (2) shall be liable on conviction after summary trial before a Magistrate to a fine not exceeding five hundred rupees or to imprisonment of either description for a term not exceeding one month, or to both such fine and such imprisonment.

(4) Any person who attempts to commit, or does any act preparatory to the commission of, any offence under this Act shall be deemed to be guilty of such offence.

122. Where the person convicted of an offence under this Act is a body corporate, every person who at the time of the commission of the offence was director or officer of the body corporate shall be deemed to be guilty of that offence unless he proves that the offence was committed without his knowledge, or that he exercised all due diligence to avoid the commission of such offence.

123. Nothing in the Companies Ordinance, No. 51 of 1938, shall apply to or in relation to the Central Bank or the Monetary Board.

124. In the event of any conflict or inconsistency between the provisions of this Act and the provisions of any other written law by or under which any banking institution is constituted or established, the provisions of this Act shall prevail.

125. The provisions of this Act shall be in addition to, and not in substitution or derogation of, the provisions of the Defence (Finance) Regulations, Defence (Finance No. 2) Regulations, Defence (Finance No. 3) Regulations and Defence (Securities) Regulations.

Defence  
(Finance)  
Regulations, &c.

126. (1) In this Act, unless the context otherwise requires—

Interpretation.

“appointed date” means the date appointed by order under section 1 ;

“banking institution” means—

- (a) any commercial bank ;
- (b) any agency or institution acting on behalf of the Government (whether established by any written law or otherwise) which makes loans, advances or investments or accepts deposits of money from the public ;
- (c) the Co-operative Federal Bank of Ceylon, Limited ; and
- (d) any other person or body of persons declared by the Minister of Finance, by order published in the *Gazette*, to be a banking institution for the purposes of this Act ;

“commercial bank” means any person or body of persons, corporate or unincorporate, which carries on in Ceylon the business of accepting from the public, or of creating demand deposits, but does not include the Central Bank ;

“current international transactions” means transactions which are not for the purpose of transferring capital, and includes without limitation—

- (i) all payments due in connection with foreign trade, other current business, including services, and normal short-term banking and credit facilities ;
- (ii) payments due as interest on loans and as net income from other investments ;
- (iii) payments, of amounts not exceeding such maxima as may be fixed by the Monetary Board, for amortisation of loans for depreciation of direct investments ; and
- (iv) remittances, of amounts not exceeding such maxima as may be fixed by the Monetary Board, for family living expenses ;

“currency”, “demand deposits” and “money supply” have the meaning assigned to those expressions by sections 48, 59 and 61 respectively.

(2) For the purposes of this Act, any question which may arise as to whether any agency or institution is an agency or institution acting on behalf of the Government shall be referred to the Prime Minister for decision ; and such decision shall be final.

#### CHAPTER VIII.—REPEALS AND TRANSITIONAL PROVISIONS

127. The Currency Ordinance, No. 21 of 1941, is hereby repealed with effect from the appointed date :

Repeal of  
Ordinance  
No. 21 of 1941.

Provided, however, that the Board of Commissioners of Currency constituted under that Ordinance and holding office immediately prior to the appointed date shall continue to hold office as such for the purpose only of carrying out the duties imposed upon the Board



by the succeeding provisions of this Chapter, and shall thereafter be dissolved upon an order made by the Minister in that behalf and published in the *Gazette*.

Transfer of  
assets of  
Board of  
Commissioners  
of Currency.

128. On the appointed date, or as soon as may be thereafter, the Board of Commissioners of Currency—

- (a) shall transfer to the Monetary Board for and on behalf of the Central Bank such part of the moneys and investments of the Currency Security Fund maintained under the Currency Ordinance, No. 21 of 1941, of a market value (as estimated by the Board of Commissioners of Currency) equivalent to the total face value of all currency notes issued or deemed to have been issued under that Ordinance which are in circulation on the appointed date, and of all Ceylon coins issued or deemed to have been issued under that Ordinance which are estimated by the Board of Commissioners of Currency to be in circulation on that date ;
- (b) shall in addition transfer to the Monetary Board for and on behalf of the Central Bank out of the balance of the moneys and investments of the Currency Security Fund, and of the balance in the Currency Income Account remaining after meeting outstanding liabilities of the Board of Commissioners of Currency (other than liabilities declared by section 129 of this Act to be liabilities of the Central Bank), moneys and investments of a total market value (as estimated by the Board of Commissioners of Currency) of twenty-five million rupees, of which value—
  - (i) fifteen million rupees shall constitute the capital of the Central Bank as provided in section 6 of this Act, and
  - (ii) ten million rupees shall be appropriated to surplus of the Central Bank ; and
- (c) shall transfer the balance, if any, of the moneys and investments of the Currency Security Fund and in the Currency Income Account remaining after the transfers referred to in paragraphs (a) and (b) to such sinking fund or funds established under the Registered Stock and Securities Ordinance as may be specified by the Minister of Finance.

Cap. 289.

Validity of  
currency in  
circulation, &c.

129. (1) The Central Bank is hereby empowered to issue any currency notes or Ceylon coins printed or minted under the authority of the Board of Commissioners of Currency and remaining unissued on the appointed date.

(2) All currency notes and Ceylon coins issued or deemed to have been issued under the Currency Ordinance, No. 21 of 1941, prior to the appointed date and in circulation on that date, and all currency notes and coins issued by the Central Bank under sub-section (1) of this section, shall be deemed for all purposes to be currency notes and coins issued by the Central Bank under this Act and to be liabilities of the Central Bank ; and the provisions of this Act shall apply accordingly to and in relation to such currency notes and coins in like manner as they apply to and in relation to currency notes and coins issued under this Act.

Amendment of  
Ordinance  
No. 51 of 1938.

130. (1) Sections 339 and 341 of the Companies Ordinance, No. 51 of 1938, are hereby repealed.

(2) Section 340A of the Companies Ordinance, No. 51 of 1938, (inserted by Ordinance No. 19 of 1942) is hereby amended as follows:—

- (a) by the omission of the word and figure “ section 339 ” ; and
- (b) by the substitution, for all the words from “ shall be liable ” to “ any other case, ” of the words “ shall be liable ”.

(3) Section 342 of the Companies Ordinance, No. 51 of 1938, is hereby amended as follows :—

- (a) in sub-section (2), by the substitution, for the word “ registrar,” of the words “ Director of Bank Supervision of the Central Bank of Ceylon ” ; and
- (b) by the repeal of sub-section (3) of that section.

131. The Registered Stocks and Securities Ordinance is hereby amended by the substitution, for section 48 thereof, of the following section :—

Amendment of Chapter 289.

48. For the purposes of this Ordinance—

“ Registrar and trustees.

- (a) the Monetary Board of the Central Bank shall appoint a person to be or to act as the Registrar, and
- (b) such Monetary Board shall be the trustees of the sinking fund established for each loan.”

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