L.5.2

RFD 504

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Division of International Finance

# REVIEW OF FOREIGN DEVELOPMENTS

September 29, 1964

Financing British Local Government
Capital Expenditures, 1945-64

12 pages

Thomas M. Klein

September 29, 1964

Thomas M. Klein

# Financing British Local Government Capital Expenditures, 1945-64

During the post-war period, the British Government has upon several occasions changed the regulations under which U.K. local authorities are able to borrow funds to finance capital expenditures. Each change was introduced because local authority finance came into conflict with the effectiveness of overall financial policy. The purpose of this paper is to describe the ways in which local authority borrowing has adapted to the changes in these ground rules.

Local authorities consist of all political substructures ranging from county councils and metropolitan boroughs to rural district councils. They accounted for nearly half of the total net capital formation of the British economy in the immediate post-war years, and, as recently as 1962, they still generated about one-quarter of the total. Local authority capital expenditure has been directed mainly into housing, although in the late 1950's expenditure on education and basic services (roads, water supplies, and sewer systems) expanded considerably.

In the post-war period, there were three phases in the financial dependence of the local authorities upon the central government. In the first post-war decade, local authorities were able to finance all their capital expenditures by borrowing from the Treasury. However in 1955, large-scale local authority borrowing from the Treasury contributed to balance-of-payments difficulties and severe inflationary pressure.

As a result, a second period commenced after October 1955 when Treasury loans were made available only to those local authorities which could not raise funds in the market.

But, with interest rates high, local authorities were somewhat diffident about raising long-term funds in the market during this period (October 1955 through March 1963). As a result, they began to borrow heavily on short-term, hoping to refinance later at lower long-term rates. In this way, a substantial market for short-term funds, drawing upon both domestic and foreign sources of funds, developed.

Because this new market created difficulties in money-market management on April 1, 1964 the Treasury imposed limits on short-term borrowing, marking the start of a third period in the financial relationship between the central and local governments. At this time, the U.K. authorities recognized that the Treasury would have to provide a major portion of the local authorities' capital expenditure requirements and so Treasury loans were once again made available, although not as freely as between 1945 and 1955.

The central monetary authorities have thus attempted to find a middle ground whereby the local authorities will be able to rely upon the Treasury for a large portion of their capital spending requirements and, at the same time, will tap market sources of finance that otherwise might not be available to the public sector. However, the problem of the local government short-term funds market continues to exist.

## Preferential Borrowing from the Treasury: 1945-55

The recovery years: 1945-52-In the immediate post-war period, physical controls carried over from the war years served to limit capital spending by British local authorities. 1/ For example, no housing construction could be started unless a permit was obtained from the Ministry of Housing. Financing for authorized projects was provided automatically by the Treasury through the Public Works Loan Board (PWLB). The funds made available to the PWLB were included in the budget, and comprised part of the Treasury's annual cash needs which were met by non-market borrowings. At the same time, to ease pressures in the capital market, local authorities were forbidden to secure finance from any source other than the PWLB. 2/

Opening capital markets to local authorities: 1953-55-A new Conservative Government allowed the curbs on local authority market borrowing to lapse at the end of 1952. Consequently, between 1952 and 1954, local authorities' borrowing from the PWLB dropped from £409 million to £260 million, while borrowing from non-governmental sources (mostly by means of medium- and long-term mortgages) rose from £50 million to £205 million. (See Table 1.) This shift to outside finance, took place even though PWLB lending rates were below comparable market rates, 3/ largely because of inflexible PWLB procedures. Local authorities could borrow from the PWLB only for terms that were related to the life of the projects to be financed. For example, housing loans had to be taken for a term of about 60 years, and local authorities could not obtain short- or medium-term loans which could be refunded later at lower interest rates. In addition, the proceeds of local authority loans were tied to specific projects; further, annual

1/ For an excellent summary of this experience, see: J.C.R. Dow, The Management of the British Economy 1945-60, Cambridge, Cambridge University Press: 1964 pp. 144-77.

2/ Some market borrowing was allowed for certain specific purposes. The Midland Bank Review (February 1953, p.2) summarizes the blanket exemptions as follows: ". . . temporary advances, as from banks, in anticipation of current revenue or for capital expenditure pending the raising of a loan; borrowing on mortgage or local bonds up to the highest amount outstanding between 1939 and 1945; borrowing from superannuation funds by authorities contributing to those funds; and the raising of money to redeem maturing securities."

3/ The PWLB lending rates in 1953 and 1954 were above the comparable government bond rates because they were adjusted at infrequent intervals whereas long-term market interest rates were falling steadily. However, the PWLB rates were still lower than the available mortgage rates.

Table 1. Financing U.K. Local Authority Capital Expenditures, Selected Years, 1948-62
(In millions of pounds)

| | 1948 | 1952 | 1953 | 1954 | 1955 | 1956 | 1962 |
|---|---|---|---|---|---|---|---|
| Revenue surplus | 78 | 83 | 115 | 117 | 110 | 130 | 218 |
| Grants from U.K. Government | 24 | 16 | 31 | 30 | 21 | 22 | 55 |
| Net borrowing: | | | | | | | |
| From U.K. Government | 258 | 409 | 328 | 260 | 414 | 91 | -34 |
| From other sources | 12 | 50 | 154 | 205 | 51 | 382 | 623 |
| Total | 372 | 558 | 628 | 612 | 596 | 625 | 862 |

Source: U.K. Central Statistical Office, National Income and Expenditure.

repayment of principal was required by the PWLB immediately after the inception of the loans even though revenues generated by capital projects (such as housing and water services) would not be forthcoming for a number of years.

The bulk of mortgages were placed directly with large institutional investors, particularly the Trustee Savings banks (private savings institutions regulated by the National Debt Commissioners). However, funds were raised in smaller amounts through mortgage brokers and local authority mortgages developed into popular investments for retired people who required both security of capital and an annual income above that available in government bonds. 4/

During this period, local authorities did not raise much money through new issues in the government bond market. The only local governmental units able to issue bonds were corporations of sufficient size and repute (such as the City of Birmingham and the London County Council) to secure good market terms.

4/ See a letter to The Financial Times by Mr. Dennis Wilsden, January 18, 1964, p. 6.

In addition to funds raised privately, local authorities continued to borrow from the PWLB in 1953 and 1954. Many governmental units were too small to float bond issues or to seek funds in the mortgage market. Also, borrowing from the PWLB was convenient since approval of a capital project by the controlling government department meant automatic approval of a loan by the PWLB. Consequently, even local authorities which intended to use outside finance would apply for a PWLB loan and cancel it when other finance was arranged. Furthermore, PWLB loans were cheaper. If the borrowing terms were satisfactory, local authorities had no reason to pay the higher rates demanded in the mortgage market. During 1954, some of the adminstrative difficulties which made the PWLB unattractive were removed.

Conflict with monetary policy-Financing local authority capital expenditure through the Public Works Loan Board created serious problems for monetary policy in 1955. As credit conditions tightened in a period of rapid expansion of domestic demand and deterioration of the balance of payments, local authorities found accomodation difficult to obtain in the mortgage market and turned back to the PWLB for finance. This additional demand upon the Treasury for financing (on top of the £500 million cash needs of the nationalized industries) made it impossible for the Government to reduce the liquidity of the banking system by funding part of the floating debt. 5/ In order to reduce bank lending, the Chancellor of the Exchequer requested that the banks make a positive and significant reduction in advances. 6/

The fact that Treasury financing of the PWLB expenditures had frustrated monetary policy was sufficient grounds for changing the procedures of local authority finance. There were also two further considerations. In the first place, the Government believed that local authorities ought to be encouraged to seek out local capital hitherto not available to the public sector. Secondly, in accordance with the principle that the rate of interest ought to be more widely used as a regulator of the supply and demand for capital, it was though that local authority capital expenditures ought to be more responsive to the market conditions. 7/ Since the most urgent tasks of rebuilding Britain's housing had been completed, there was no longer an a priori case for placing local authority capital spending in a privileged position.

---

5/ With the Treasury persistently in deficit, partly owing to its finance of local authority capital expenditures, the Government attempted to control commercial bank liquidity by financing its borrowing requirements as far as possible through the sale of bonds rather than Treasury bills. Commercial bank acquisition of Treasury bills increased bank liquidity ratios and hence their ability to expand loans. For an account of this problem of government finance in 1955, see: Cmnd. 827, Committee on the Working of the Monetary System: Report, (Radcliffe Report) pars. 415-18.

6/ Ibid., par. 147

7/ The Chancellor of the Exchequer expressed these views in his October 1955 budget address as follows ". . . Since the tap is open from which local authorities can draw the money when their capital commitments mature, they have less incentive to consider, before they incur the commitments, how the money to meet them will be found. Their sense of financial responsibility is also weakened if they borrow at rates which reflect not their own credit but the credit of the Government." See: House of Commons Debates, October 26, 1955, c. 214

## Financing Local Authorities in the Market: 1955-63

Closing the PWLB-A radical change in the methods of financing local authority capital expenditures was announced in the October 1955 special budget. Local authorities found the Public Works Loan Board closed and were directed to raise funds in their own name in the bond market or in the mortgage market. Those authorities too small to borrow on the market were permitted to borrow from the PWLB at ". . . a rate reflecting, not government credit, but the credit of local authorities of good standing in the market for loans of comparable period." 8/

Local authority bond issues blocked-The access of local authorities to the market was restricted by the Bank of England, which regulated the timing of all bond issues over £1 million. 9/ The new policy of using the market rate of interest as a regulator of local authority capital expenditures was introduced in a period of general monetary restrictions which lasted through 1957. Bond prices fell steadily, and the Treasury had great difficulty in floating new issues. 10/ Therefore, in an effort to keep local authority issues from further depressing the already weak long-term market, the Bank of England, permitted only a small number of securities to be floated. Localities had to wait not just months but, in many cases, years before being able to issue bonds after their applications had been proposed to the Bank of England. 11/ In the fiscal years 1955-56 to 1957-58 bond issues accounted for less than 10 per cent of new money raised by local authorities. (See Table 2.)

Resorting to temporary finance- Denied access to both the bond market and the PWLB, local authorities turned to short-term financing. Between March 31, 1955 and March 31, 1958, temporary borrowing (loans maturing in less than 12 months) averaged £96 million per year, the bulk being loans due in less than one week. In each of the years 1958-62, temporary borrowing increased substantially. (See Table 2.) In the year ending March 31, 1962, temporary borrowing increased by almost £300 million and then totaled 18 per cent of the outstanding local authority debt. Over half of this sum consisted of loans falling due in less than a week. Funds were readily available from overseas banks, discount houses, industrial and commercial lenders. Investors were encouraged to place funds in this market by the attractive yields and by the absence of credit risk: the PWLB was thought to stand as a lender of last resort to local authorities much as the Bank of England is a lender of last resort to the discount market.

## Problems Caused by Temporary Borrowing: 1956-63

Insensitive to monetary policy-The dependence of local authorities in recent years upon short-term financing posed a new threat to the effectiveness of monetary policy. Local authority short-term borrowing created a large pool of assets which could be converted to cash in a relatively short time, making the

8/ House of Commons Debates, October 26, 1955, C. 214
9/ Radcliffe Report, par. 224
10/ Ibid., par. 564
11/ Ibid., par. 93

Table 2. Composition of Local Authority Loan Debt in Great Britain, 1955-62 1/
(In millions of pounds)

| | Outstanding Mar. 31, 1955 | | Changes to March 31: 1958 2/ | 1959 | 1960 | 1961 | 1962 | Outstanding Mar. 31, 1962 | |
|---|---|---|---|---|---|---|---|---|---|
| Market Finance | | | | | | | | | |
| PWLB loans | 2,728 | (69%) | +118 | -29 | -88 | -45 | +40 | 2,959 | (45%) |
| Local authority mortgage | 596 | (15%) | +125 | +173 | +208 | +88 | +209 | 1,650 | (25%) |
| Securities quoted or stock exchange | 424 | (11%) | +26 | +19 | +36 | +49 | +43 | 648 | (10%) |
| Temporary borrowing | 133 | (3%) | +96 | +134 | +92 | +211 | +292 | 1,151 | (18%) |
| Other market finance 3/ | 74 | (2%) | +14 | +24 | +14 | +14 | +1 | 169 | (3%) |
| Total | 3,956 | (100%) | +379 | +321 | +262 | +317 | +584 | 6,576 | (100%) |
| Borrowing from own Pension Funds, etc. 4/ | 295 | | +37 | +41 | +45 | +74 | +9 | 574 | |
| Total loan debt | 4,251 | | +416 | +362 | +307 | +391 | +593 | 7,151 | |
| Term of Temporary borrowing: | | | | | | | | | |
| Up to 7 days | 104 | (78%) | +57 | +37 | +58 | +137 | +148 | 656 | (57%) |
| Up to 3 months | 23 | (17%) | +21 | +38 | -2 | +68 | +130 | 318 | (28%) |
| Up to 12 months | 7 | (5%) | +19 | +58 | +36 | +6 | +14 | 177 | (15%) |
| Total | 133 | (100%) | +96 | +134 | +92 | +211 | +292 | 1,151 | (100%) |

1/ Details may not add up to totals due to rounding.
2/ Annual average, 1955-58.
3/ Includes corporation and local bonds.
4/ Advances from authorities' own pension funds, advances from other internal funds, and revenue balances temporarily used for capital purposes.

Source: U.K. Treasury, "Annual Treasury Survey of Local Authority Loan Debt," in Central Statistical Office, *Economic Trends*, February 1961, February 1963.

monetary authorities' job of controlling spending in a period of excess demand more difficult. During the credit squeeze of mid-1961, the banks reported that local authority Treasurers were able to turn to the London loan market for temporary funds when their bank over-drafts were out. 12/

Conflict with the balance of payments objectives-Another problem was that the local authorities short-term funds market hampered the use of interest rate policy to control flows of foreign funds in and out of the London money market. This problem became acute in the early months of 1962 when the monetary authorities were attempting to curb the substantial capital outflow that was taking place in response to the relatively high interest rates prevailing in London and the revived confidence in sterling. (See Table 3.)

Table 3. U.K. Local Authority Deposit, Treasury Bill and Selected Yield Spreads, 1962
(In per cent per annum)

| | Jan. 5 | Feb. 2 | March 2 | April 6 | May 4 |
|---|---|---|---|---|---|
| Bank Rate | 6.00 | 6.00 | 6.00 | 4.50 | 4.50 |
| 3-Month Yields | | | | | |
| Treasury bill | 5.27 | 5.09 | 5.37 | 4.22 | 3.92 |
| Local authority deposits | 6.50 | 6.38 | 6.47 | 5.50 | 4.94 |
| Covered Arbitrage (favor U.K.) | | | | | |
| U.K./U.S. Treasury bills | -0.22 | -0.12 | +0.15 | -0.29 | -0.08 |
| Local authority deposits vs. Euro-$ deposits | +0.24 | +0.34 | +0.31 | -0.02 | +0.06 |

Source: Bank of England and Federal Reserve Bank of New York.

Foreign funds were placed mainly with acceptance houses and overseas banks (both in sterling and in Euro-dollars). These institutions, in turn placed proceeds with local authorities to obtain the 100-120 basis point differential in favor of a 3-month local authority deposit over the British Treasury bill yield. (See Table 3.) In addition, foreigners were placing funds directly with local authorities. 13/

12/ The Economist, August 18, 1962, p. 631.
13/ Bank of England, Quarterly Bulletin, Vol. II, No. 1 (March 1962), p. 7.

Restrictions on Temporary Borrowing and Re-Opening the PWLB

In 1962, the Government decided to check the expansion of this short-term borrowing. After prolonged discussion with local authority Treasurers, a White Paper was issued in October 1963 explaining the Government's new policy. 14/ Necessary legal changes were enacted in the Local Authorities (Financial Provisions) Act of 1963.

Limits on temporary borrowing-The following restrictions upon temporary borrowing were imposed, effective April 1, 1964: (1) Total temporary borrowing (loans maturing in less than 12 months) must not exceed 20 per cent of a local authority's outstanding loan debt or one and one-third times its capital expenditure in the preceding 12 months, whichever is higher. (2) Loans maturing in less than 3 months must not exceed 15 per cent of a local authority's outstanding loan debt or its capital expenditure in the preceding 12 months, whichever is higher.

Re-opening the PWLB-At the same time, local authorities were once again allowed to secure part of their loan requirements from the PWLB. However, the PWLB was to be opened gradually over a four-year period, so that the Treasury's borrowing requirements would not increase too rapidly in the current fiscal year. In fiscal 1964-65, local authorities could secure only 20 per cent of their long-term needs from the PWLB. This figure is to be increased by 10 percentage points in each of the following fiscal years until a maximum of 50 per cent is reached in the year commencing April 1, 1967. By restricting the proportion of financing that can be obtained from the PWLB, it is hoped that local authorities will continue to tap local sources of finance not available to the Central Government.

PWLB interest charges reduced-Under the new regulations PWLB loans once again carry interest charges comparable to those prevailing on government bonds. This change was in response to persistent criticism of the attempt to restrict local authorities' capital expenditures by increasing their cost of borrowing. As the Radcliffe Report pointed out, ". . . the level of (local authority) capital investment is now largely determined by the requirements of social legislation, and is closely controlled by the Central Government." 15/ Higher interest rates, therefore, have not restricted local authority borrowing; they have shortened the maturity of local authority debt.

Between 1961 and the end of 1963, local authority mortgage rates ranged between 25 and 50 basis points above the yield on government bonds of comparable maturity. (See Table 4.) As the demand for long-term local authority mortgages eased after the October White Paper on local authority finance was issued, the gap between the rates and the government bond rates narrowed. The differential between Treasury and local authority short-term borrowing rates have remained substantial, with 3-month local authority deposit rates fluctuating between 70 and 100 basis points over the Treasury bill rate.

14/ Local Authorities Borrowing, Cmnd. 2162 (October 1963).
15/ Radcliffe Report, par. 596.

Table 4. Local Authority and Related Debt Yields
1955 and 1961-64
(In per cent per annum)

| | 1955 | | 1961 | | 1962 | | 1963 | | 1964 |
|---|---|---|---|---|---|---|---|---|---|
| | June | Dec. | June | Dec. | June | Dec. | June | Dec. | June |
| **Long-term yields** | | | | | | | | | |
| PWLB loans (15-30 yrs.) | 4.00 | 5.00 | 6.50 | 6.75 | 6.75 | 5.88 | 5.75 | 5.75 | 6.00 |
| Local authority mortgage borrowing rate (over 15 yrs.) | n.a. | n.a. | 6.50 | 6.75 | 6.62 | 5.81 | 5.75 | 5.75 | 6.00 |
| Long-term govt. bond yields a/ | 4.15 | 4.39 | 6.36 | 6.46 | 6.20 | 5.45 | 5.30 | 5.65 | 5.93 |
| **3-Month yields:** | | | | | | | | | |
| Local authority deposits | n.a. | n.a. | 6.12 | 7.00 | 4.56 | 4.87 | 4.31 | 4.56 | 5.00 |
| Treasury bills | 3.97 | 4.09 | 4.44 | 5.28 | 3.84 | 3.66 | 3.63 | 3.61 | 4.35 |

a/ 1955: 3-1/2 per cent War Loan; 1961-64: 5-1/2 per cent Treasury Bond, 1982-84.
Source: Bank of England.

## The Response of Local Authorities

One-year bonds-In spite of the controls on temporary borrowing, the problem of the local authorities' short-term borrowings continued. On February 26, some six weeks before the regulations limiting the temporary borrowing became effective, the City of Manchester placed with the discount market an £0.5 million negotiable one-year bond issue--a maturity only one day longer than "temporary borrowing" as defined in the new regulations. A second issue of £1 million was placed on March 11, and it was taken up by a number of discount houses rather than a single institution as with the first issue. Manchester continued to raise funds in this fashion; by July 1, it had £4 million outstanding in one-year bonds.

New regulations, effective in early July, under the Local Authorities (Financial Provisions) Act of 1963 gave all local authorities the power to issue "Yearlings" (only Manchester and Berkshire could do so until then), and 15 local authorities entered the market a few days later with one-year bonds of their own with a total value of £95 million.

In March, the discount houses accepted Manchester's one-year bonds with great enthusiasm, since these bonds provided them with an investment having a maturity to fill the gap between the 3-month Treasury bill and the shortest-dated available government bond--18 months in February 1964. Furthermore, the one-year bonds provided the discount houses with a jobbing opportunity, as the bonds were attractive to institutional investors and even to industrial companies.

The one-year bonds also proved to be a relatively inexpensive means of finance because of the current strong market demand for these securities. The one-year bonds issued in early July had a coupon of 5 per cent at a time when the deposit rate on 364 day money was 5-1/2 per cent and an interest charge on one-year mortgages of 5-3/4 per cent.

The monetary authorities, however, viewed these one-year bonds as an attempt to contravene the controls on temporary borrowing, and they were quick to display their displeasure. The Treasury, in a circular to local authorities, stated that ". . . it would be a matter of concern to the Government if the imposition of control on local authority borrowing for less than twelve months were to be accompanied by a sharp rise in borrowing for a fractionally longer period." 16/

There was also concern that a large, uncontrolled issue of these bonds marketed through the discount houses might be used as collateral for discount market borrowing at call from the commercial banks and thus expand the commercial banks' credit base--possibly at a future time when the Bank of England might be attempting to restrict bank liquidity.

Therefore, immediately after the early Manchester issues, the Bank of England decided not to accept one-year local authority bonds as collateral for advances to the discount houses. The Bank also requested that the discount market restrict its total holdings of one-year local authority bonds to £100 million. Later, this ceiling was lowered to a range of £30 million to £40 million. The London clearing banks were told in turn that ". . . it would not be welcome if the banks accepted large amounts of these new bonds as call money collateral." 17/

For their part, the discount houses expressed concern that there be a spread of maturities on the market. This desire meant that the amount of one-year bond issues that can be placed at any one time would be limited. 18/

Nevertheless, the Bank of England has been given complete control over the issue of one-year local authority bonds. In early July, the Control of Borrowing Order of 1958 was amended so that all local authority bond issues (not merely those in excess of £1 million) will require Bank approval as to their amount and

16/ Quoted in The Economist, April 4, 1964, p.65
17/ The Times (London), May 15, 1964 p. 19
18/ The Financial Times, June 27, 1964, p. 9

their timing. For the first proposed local authority issues under the Local Authorities (Financial Provisions) Act of 1963, the Bank required that one-year bonds be issued along with bonds of a longer maturity. 19/

There have also been reports that the British monetary authorities sought to direct one-year issues from the discount market to the bond market. According to these reports, the Stock Exchange Council was asked to lower the cost of issuing one-year bonds so that Government bond dealers will be able to compete effectively with the discount houses for placing these issues. However, in July £4.5 million of yearlings were placed in the discount market along with £5.0 million in the government bond market. It appears likely that one-year bonds will continue to be placed directly with the discount markets as well as being offered on the stock exchange.

Local authority mortgages-Since April 1964, there has been a slackening of long-term mortgage borrowing as Treasury funds became available once again through the PWLB. However, two relatively short-term mortgage instruments have become important since April. One is a 2-to-3 year mortgage which, can be repaid after one year, upon the demand of either the borrower or the lender on one month's notice. However, these loans are normally expected to run until maturity. A second type of issue is repayable on one month's notice after a term of eleven months; these loans are expected to terminate within two years.

## Concluding Observations

The local authorities have demonstrated their ability to raise substantial medium- and long-term funds in their own name on financial markets. Local authority bond issues in 1962 and 1963 have been successful; more money was raised in these channels in these two years than in the previous seven years combined. The limited bond sales prior to 1962 has been attributed primarily to barriers imposed by the monetary authorities, and not to difficulties inherent in local authority bonds *per se*; local authority bonds were held back so that they would not spoil the market for the issue of bonds by the Treasury itself.

As a result of these bond sales, the local authority mortgages market has attracted into the public sector local funds which might have otherwise been utilized elsewhere. The value of local authority mortgages outstanding almost trebled between March 31, 1955 and March 31, 1962.

A further indication of the ability of local authorities to tap available financial resources is their quick response, with one-year bond issues, to the restrictions on temporary borrowing. This has demonstrated the ability of astute local authority treasurers and underwriters to raise funds by taking advantage of a gap in the government debt structure--despite initial official disapproval of the technique used.

19/ *The Times* (London), July 8, 1964, p. 16.

In spite of the ingenuity of local authority Treasurers, however, it was not possible in the eight years following the closing of the PWLB for local authorities to finance their capital expenditures without resorting to large-scale temporary finance. Therefore, perhaps the main conclusion we can draw from the review of the post-war financial arrangements in Britain is that local authorities must be able to secure long-term funds from the central government.

But, now that local authorities are able once again to borrow on a large scale from the PWLB, the monetary authorities must face the possiblity that at some time in the future, their ability to restrict credit might be impeded as in 1955 by the Treasury's responsiblity of raising funds to finance local authority capital expenditures.

Two features of the credit mechanism today may make this problem less serious than it was in the mid-1950's. First, the commercial banks are no longer excessively liquid as they were in the mid-1950's. Secondly, should the monetary authorities desire to restrict the lending ability of the London clearing banks and the Scottish banks at a time when their liquid assets are increasing, Special Deposits could be called, requiring these banking institutions to held additional deposits with the Bank of England up to 3 per cent of their gross deposit liabilities. In this way, the monetary authorities are thought to be better able to offset deficit financing through the banking system than they were a decade ago.