A THIRD TECHNIQUE for controlling the money supply is the use of Special Deposits. It was applied with most enthusiasm in the 1960s and 1970s. In 1990 the Labour Party announced that this was the control technique which it would use if it ever gained power. When Labour got power in 1997, the promise was very sensibly forgotten.

The services of Central Banks, such as the Bank of England, are available only to a very few customers. The principal ones are the government, government departments, important financial institutions such as discount houses, the clearing banks, market-makers in government stocks, and the former Guardian Royal Exchange Assurance which had a historical connection. A clearing bank’s deposit at the Bank of England is conventionally regarded as its most liquid financial asset after cash, and it is the deposit on which it may need to draw in order to make a remittance to another clearing bank.

There is little point in any bank drawing a cheque upon itself in order to pay money to another party, for that cheque could only be honoured by the recipient using it to open an account with the bank on which it was drawn, a procedure which does nothing at all to change the initial creditor-debtor relationship. Therefore a payment from a bank should ideally be by a cheque, or other form of remittance, which is drawn on an account with some third party, preferably one with the Bank of England.

The Banking Department of the Bank of England, like any other financial institution, must balance its books. If it holds a bank’s deposit, it must either make a loan to match it, or buy an investment (an investment is just another form of lending), or else it must hold some form of currency. The currency can be its own, in which case it becomes a creditor of its own Issue Department, which, in turn, holds investments to balance the liability created by the issue of currency. Fortunately the
government is usually a ready borrower from the Bank, whether from the Banking Department or the Issue Department, and it is usually not only willing but eager to mop up surplus funds. Consequently in normal times much of the lending made by the Bank of England is to the central government.

When inflation began to be a cause for special concern in the 1960s, the idea that it was attributable to an excess of money caused economists to apply their minds towards the possibility of reducing the supply of money by artificial means. One fashionable method for doing this was to force the banks to deposit more money with the Bank of England than they might otherwise prefer. These additional deposits were called *Special Deposits*, and they were to be fixed and frozen: the banks could use them neither for their ordinary business nor as reserves. The size of the special deposits was fixed at a stated percentage of the banks’ own deposits, though the percentages might differ with regard to each class of deposits, long term deposits tending to be totally exempt. In order to make special deposits into a kind of punishment or discipline they commonly earn less than a market rate of interest, and sometimes earn no interest at all. Unless special deposits are required pro rata from every deposit taking/lending institution they can be discriminatory and grossly unfair.

**Negative feedback from banks**

It is worth noting the reaction of the banks to special deposits; it is an example of the reactive relationship between economic planners and those subjected to planning. The banks examined all their accounts, and eliminated every possible offset account, so that the special deposit was levied on the smallest possible sum. As a result of their action, there is a small but incalculable discontinuity in the published statistics of the money supply.

A close look at the detailed bookkeeping of special deposits reveals that the only way a bank can make a deposit at the Bank of England is to obtain, directly or indirectly, some form of financial instrument which is drawn on the Bank of England. That financial instrument could be banknotes, but they are an unlikely payment medium because, as currency does not earn interest, the banks keep only sufficient to enable them to cover their customers’ day by day demands for it. As already explained, it is pointless for a bank to give to the Bank of England a cheque drawn on itself: that can only force the Bank of England to lend the money back to the originating bank. If the bank has money owing to it by another bank, it can draw on that bank instead. This would cause the