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**A CRITICAL STUDY
OF GOLD RESERVES AND THE
MONETARY STANDARD**

A CRITICAL STUDY OF
GOLD RESERVES AND THE
MONETARY STANDARD

*With special reference to the
position of the Bank of England ;*

AND

AN OUTLINE OF A PROPOSED
MONETARY SYSTEM FOR THE BRITISH
COMMONWEALTH OF NATIONS

BY

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INTRODUCTORY NOTE

CURRENCY matters are tending to slip too easily into the position of political counters or political dogmas. There is need for a greater degree of dispassionate calm and good humour when approaching the monetary problems now suspended like imminent avalanches over the heads of the world's responsible statesmen and central and commercial bankers. This short study represents an attempt to assist in a more judicial survey of the gold standard's efficacy over a longer period than is currently taken into consideration in a number of quarters. Pronouncements by leading statesmen on the floors of parliaments and at welcoming dinner-tables often raise the question whether the true statistical aspects of the gold question have as yet been widely studied. Such a study must lead on to an examination of the possibility of introducing a higher degree of management into a gold standard which without it may prove so easily to be a jilting mistress.

The writer has therefore attempted to deal with the case for a managed gold sterling standard from a new angle. The modifications which he suggests in the administrative arrangements of the currency system involve no interference with the existing provisions whereby the British note-issuing and credit-controlling authorities find themselves independent of political and undesirable business pressure. His efforts are made as a contribution to that searching for a re-orientation in currency

practice which the statistics of gold supplies, needs and utilisation, and the conservation of improved versions of our present economic structure, seem urgently to demand.

The central bankers and statesmen of to-day shirk their duty to their proximate generations in an inexcusable manner if they do not take a longer view in currency matters than that which ran through the League of Nations' recent Gold Delegation's investigations. We must question and doubt, devise and reconstruct. This slim volume should therefore be taken as an expression of critical yet constructive thought. Written from a purely independent standpoint, it is the outcome of the author's private work and reflection, and in no way must it be connected with any position he may hold in a British financial institution.

DOUGLAS S. EDWARDS.

Hull,
January 27th, 1933.

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D. S. E.

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CHAPTER I

A SURVEY OF THE GOLD DÉBÂCLE

RIGIDITY in the note-issue system and the higher development of central banking practice have been strangely and almost stubbornly intermingled in this country since 1844. When one dips into the memories of nineteenth-century controversies, probing the statements of Bank of England Governors and Deputy-Governors at parliamentary inquiries, weighing the bluntness of criticisms from such men as Bagehot, or Palgrave with his streak of "gold worship," and then compares the fundamentals of Bank of England activity which emerge with those revealed officially before the United States National Monetary Commission of 1910 and the Macmillan Committee of 1929-30, it must be acknowledged that enormous strides have been taken by the Bank in its conception of the social duty it has to perform.

The major importance, *pari passu* with Government Deposits, of accounts other than those which private persons and firms maintain with the Bank, or, in other words, Bankers' Deposits, was ultimately accepted in the fourth quarter of last century, as well as the accompanying implication that the reserve in the Banking Department formed the main bulwark of the banking structure pivoting on London.

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From this it was but a rapid step to the realisation that this reserve had become the lever with which to control the commercial banking position. The extent of this control widened particularly in the 'eighties and 'nineties, as private banking firms were united with joint-stock banking institutions, and these in their turn sought or expanded connections in the London market. It only remained, therefore, for the Bank to appreciate fully how to handle the dual machinery—Bank Rate and, to an almost minor extent, open-market policy—with which this lever was worked in the bliss of adequate gold supplies and the rarity of "extraneous political factors" which characterized the period from the 'nineties up to 1914.

BANK RATE AS A REGULATING FACTOR

Yet even that fearful weapon of the Bank Rate had to struggle for its present position of awesome eminence.¹ Up to the year 1844 it had remained practically a fixed rate, the regular level being 4 per cent., with occasional rises to 5 per cent. The increase to 6 per cent. for a short period in 1839 could be regarded as an ominous measure.² With the passage of the 1844 legislation more frequent changes were accepted as in the normal course of events, though for several decades the Bank Rate's exact relation to market rates remained unsettled.

¹ See R. H. I. Palgrave's "Bank Rate and the Money Market," Chapters V, VI and VII. (John Murray, London, 1903.)

² These statistics of Bank Rate changes are taken from Palgrave's record in the above-cited work.

The Bank, nevertheless, endeavoured from 1844 on to regulate its discount rate approximately in accordance with the market rate, since it still regarded itself as an important competitor with other banks in the bill market.¹ At times Bank Rate ranged a little above, at others a little below, the general level of outside rates. This uncertainty led to some feeling between the Bank and its banking "rivals," which culminated in a species of revolt amongst the joint-stock banks in December 1857, against the practice on their part of following the Bank Rate, the London and Westminster Bank playing a leading *role* in this break. The Bank of England rate had been moving upward in the autumn of that year, but when 9 per cent. was reached on November 6, 1857, the London and Westminster asserted its unwillingness² to raise its own deposit allowance rate in the wake of Bank Rate to a higher level than 8 per cent. Three days later the pressure on the Bank of England resulted in the raising of Bank Rate to 10 per cent., but the London and Westminster held firmly to its resolve. The Westminster had previously endeavoured without success to induce other London joint-stock banks to hold their deposit allowance rates to a maximum of 7 per cent. After putting the new policy fully into effect in December 1857, the Westminster chose to describe its rate as an "expedient" one. It deliberately did not follow Bank Rate so closely as hitherto. Conversations

¹ Palgrave, *op. cit.*, p. 49.

² See evidence by Sir David Salomons before the Select Committee of the House of Commons on the Bank Acts, 1858, paras. 1133, 1145, 1164-7, 1209-12.

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with the other London joint-stock banks which then took place resulted in a general understanding that henceforward they would all determine their deposit rates independently of the Bank of England's Rate. There was to be no common agreement regarding a deposit rate, however, since fair competition prevailed amongst them, but before making any important changes in their individual rates the other banks were to be made aware of the step being taken.

The Bank of England's discount rate thus lost its hold on the banking system's rate structure for a number of years. Bill discount rates naturally felt the repercussions of the joint-stock banks' decisions, and the new tendency was reflected in the fact that for each of the next seven years¹ the annual average Bank Rate exceeded the annual average of the market rate for high-class bills. Nor, except in 1865, was the difference excessive in the years between 1865 and 1871, when the average market rate stood at a higher level than the annual average Bank Rate. In effect, after the London and Westminster Bank's change of policy, the Bank of England Rate generally ranged well above outside rates. A decline in the central institution's bill business naturally resulted, and in order to maintain a measure of its former discount business, the Bank of England decided in 1878 that the published rate would not necessarily be enforced when conducting discount business for those who were exclusively its private customers. At the same time, the announcement was made that the Bank would be fully prepared

¹ See table 4, Palgrave, *op. cit.*, p. 33.

to fulfil its function of central support to the money market by making advances to bill-brokers when these were needed. This had been its general practice up to March, 1858. The 1878 decision however, related only to advances to bill-brokers and discount companies against the bills, and not to an outright discount. The right to the latter was not accorded until July 1890, when the Bank announced that the brokers and discount houses could offer bills for discount having not more than fifteen days to run—a period which was subsequently extended to sixty days.

At the present time the Bank maintains a definite set of qualifications regarding the nature of bills acceptable for discount, and these are regulated by the directors from time to time.¹ Sir Ernest Harvey stated before the Macmillan Committee that these regulations "have been taken more or less as a model by most foreign Central Banks." Such bills must bear at least two good British names, one of which must be the acceptor. No minimum is fixed for the amount of the bill,² and the maximum tenour taken is four months, or six months in exceptional cases. The Bank is prepared to discount approved bills which are offered to it by firms having properly constituted accounts, and the existence of this account forms a definite prerequisite. Foreign bills, or bills payable in foreign countries, are not ordinarily taken,

¹ "Report of the Committee on Finance and Industry," 1931, para. 95.

² Report of the interview between the Governor and Directors of the Bank of England and the United States National Monetary Commission, 1910.

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whilst the Bank tends to discriminate against accommodation bills pure and simple. Further, it is no longer the Bank's custom to employ surplus funds in the purchase of bills from the discount houses. Bills have to be offered to the Bank, and a large part of the supply emanates from the colonial and foreign exchange banks, but not from the clearing banks, since these do not customarily come to the central institution for rediscounts. A bill need not necessarily be of prime quality to meet with approval. When the level of market rates warrants the action, the Bank of England usually takes bills from a merchant house having a good account with it at market rate. If the clearing banks departed from their traditional method of raising cash quickly by calling money market loans, and came to the Bank of England for discounts, they would have to pay Bank Rate.

BANK RATE AND OPEN-MARKET POLICY AFTER THE GREAT WAR

Granted the rigid nature of the currency system and the perpetuation of the division of the Bank into two departments, the grip of Bank Rate on the British economic structure had become fairly complete by 1890, so long as the full power of the 1844 Act was maintained in force. Bank Rate was undoubtedly the favoured corrective when the foreign exchanges went wrong and price levels had to be adjusted. An open-market policy does not appear to have been utilised with full appreciation in the pre-War period of the present century. Its use became

more frequent and important in the post-War years, particularly after the decision to restore the gold standard in this country had been taken. In combination with Bank Rate, or even stealthily by itself while the more spectacular Bank Rate stood still, it has been acknowledged as a potent force in the attempt to preserve higher differential rates in London compared with those of New York and Paris, in order to adjust the relative price position in Britain. The resulting consequences came as a joy to all disputatious economists, and later still ended up as the football of political orators.

In the light of events during the past eighteen months, it is improbable that the gap between the commodity price level in Great Britain and those in the disturbing gold centres of the United States and France was ever completely closed. France is, perhaps, an unfair case to cite, for it is generally accepted that the franc was under-valued at the time both of its *de facto* stabilisation in 1926 and of its legal definition in 1928. The natural outcome of this was an upward movement in French price indices until the early part of 1929, a tendency which assisted in bringing the level of French wholesale commodity prices, reckoned on a pre-War gold basis, into closer alignment with that prevailing in the United States. Britain had not to scale down to the French level, but had only to approach the American dollar-gold plane. In these circumstances, and bearing in mind the volume of French Bank and Treasury balances accumulated in London during the years of soaring franc quotations, the finer points of open-market

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transactions came to light as what might be termed "unnatural" French gold withdrawals from Britain took place. French balances in London were repatriated as the easiest form of reserve realisation available to French banks in order to meet cash requirements at home in 1928 and 1929. Despite much apprehensive clamour due to fears concerning the movements of a defensive Bank Rate, the Bank of England appears to have treated the gold exports of 1929 to France as unconnected with price adjustments, and proceeded to purchase Government securities in order to rebuild the depleted reserves placed with it by the commercial bankers.

Up to quite a recent period the Bank has thus been developing and testing out its weapons of manoeuvre. Industry and labour have at times cried out against its "yoke." Their entreaties apparently did not altogether pass unheard, for Bank Rate—the striking visible instrument of restraint—was held almost ostentatiously at $4\frac{1}{2}$ per cent. from April 21st, 1927, to February 7th, 1929.

It is true that the relative price level situation in the States and Britain could not be said to warrant an increase in the Bank of England's Rate during this period. Taking the monthly average wholesale index number of the Board of Trade (1913 = 100), the sterling price level fell by barely $1\frac{1}{2}$ per cent., or from 140 to 138, between April, 1927, and February, 1929. A comparison of the American Bureau of Labor Statistics wholesale price indices (1926 = 100) for these two months showed a rise of just over 3 per cent., or from 94 to 97, in the intervening period.

If this tendency for American prices to rise relatively to the sterling level could only have been continued, the cares of those in the United Kingdom who felt the need for an increased measure of price equilibrium between the two countries would have been considerably lightened. Despite this favourable development of affairs from the United Kingdom standpoint, some measure of deflationary "adjustment" within the country by the Bank of England appears to have been thought still necessary. Thus, between April, 1927, and February, 1929, the monthly average of Bankers' Deposits in the Banking Department moved downwards from £64.4 millions to £62.4 millions, a fact which, had it not been countered by some relaxation in the commercial banks' policy with regard to reserve ratios of cash against deposits, would normally have been followed by a contraction in the deposits of the ten clearing banks. Further, if the commercial banks had kept to their previous ratios between advances and deposits, they would in all probability have felt compelled to scrutinise applications for advances with extremely tight fists. As it was, the commercial banks attempted to spare industry and trade from the contractionary consequences of the British central bank's policy. It would be difficult to maintain that during these twenty-two months British industry and trade were definitely stable in volume, or even on the decline. The Bank of England's figures therefore reflect an obvious deflationary action. Yet Bank Rate did not move. Fewer people follow the significance of the course of Bank of England statistics than those

who would be stirred by a change in the Bank Rate. Besides, the figures of Bankers' Deposits in the Banking Department were not given out separately week by week prior to November 22nd, 1928, and it has only been possible to reconstruct what actually took place by examining figures¹ which were put before the Macmillan Committee of 1929-30 and published in an appendix to its Report. The Bank appears to have proceeded to its contractionary move through a drastic reduction of "Securities" (*i.e.* Government Securities plus "Securities: Other Securities" held² in the Banking Department) by £23.2 millions over the period in question. The manoeuvre was effected primarily through the "Securities: Other Securities" item, which was not revealed separately in the weekly return before November 22nd, 1928, but was merged and obscured in the item "Other Securities," which also contained what are now published as "Discounts and Advances" in each weekly return. Public attention was directed in 1928 more to the item of "Government Securities"

¹ See the statistics in the Macmillan Committee's Report (Cmd. 3897), pp. 302-303.

² Sir Ernest Harvey, of the Bank of England, explained to the Macmillan Committee on December 5th, 1929, that the item "Government Securities" in the Banking Department included all *direct* securities of the British Government, *i.e.*, long- and short-dated Government stocks, Ways and Means advances, as well as Treasury Bills bought by the Bank on its own initiative, but not Trade Facilities Stocks and any issue merely guaranteed by the British Government. Treasury Bills discounted by the Bank on the initiative of a client would be entered under "Discounts and Advances." Any commercial bills the Bank buys on its own initiative would be counted among the "Securities: Other Securities" item in the Banking Department, as would Government guaranteed stocks, any Indian, colonial or foreign securities, and miscellaneous securities.—*Minutes of Evidence.*

in the Banking Department for any indications of open-market policy, and the increase of £11·6 millions in these between April, 1927, and February, 1929, was both misleading and confusing. The effects of this increased purchase were more than wiped out by a reduction of £34·8 millions in "Securities: Other Securities" in the same period. Thus a deflationary grip was kept on the main

(Figures in Millions of Pounds.)

Bank of England—Banking Department.						Ten Clearing Banks.		
	Bankers' Deposits.	Government Securities.	Other Securities: Securities.	Government Securities + Other Securities: Securities.	Reserve of Notes and Coin.	Total Deposits.	Ratio of Cash to Total Deposits.	Advances (i.e. Loans and Overdrafts).
1927.								
April	64·4	36·3	51·4	87·9	35·3	1679	11·65	928
May	62·6	47·3	28·5	76·0	37·4	1687	11·55	929
June	68·4	50·9	32·0	82·9	35·0	1722	11·79	931
July	67·5	49·1	32·3	82·4	33·4	1719	11·47	935
Aug.	64·9	52·7	32·4	85·1	34·4	1706	11·43	934
Sept.	63·1	55·4	35·8	91·2	34·6	1705	11·49	935
Oct.	64·2	49·8	40·7	90·5	34·9	1747	11·40	939
Nov.	61·0	41·9	42·9	84·8	35·0	1731	11·29	931
Dec.	73·4	45·1	45·4	90·5	32·5	1766	11·66	930
1928.								
Jan.	75·9	39·9	44·7	84·6	38·7	1784	11·28	938
Feb.	61·2	33·9	45·2	79·1	42·1	1734	11·10	933
March	63·7	31·7	48·4	80·1	42·8	1709	11·12	945
April	59·5	32·2	47·4	79·6	42·9	1728	11·06	949
May	61·0	29·8	46·8	76·6	46·3	1725	11·12	951
June	68·3	33·3	44·1	77·4	53·3	1769	11·17	945
July	75·3	29·8	40·2	70·0	58·3	1786	11·03	947
Aug.	65·0	28·8	37·0	65·8	58·3	1768	11·05	947
Sept.	65·6	31·2	34·2	65·4	60·8	1769	11·14	946
Oct.	62·8	36·4	30·8	67·2	52·6	1790	10·95	954
Nov.	61·9	47·4	25·4	72·8	50·4	1789	11·01	957
Dec.	68·8	62·0	19·0	81·0	36·7	1843	11·23	960
1929.								
Jan.	67·6	55·1	15·9	71·0	49·8	1846	10·92	972
Feb.	62·4	48·1	16·6	64·7	57·0	1814	10·47	983

basis of the commercial bankers' credit and advance policy, and the Reserve in the Banking Department of the Bank of England was consciously swollen to an unusual extent with what might fairly have deserved that sadly overworked description "idle money." The statistical unfolding of this course of events can clearly be seen from the table on page 11.

The Bank had evidently not yet abandoned the desire for a respectable equation of our price level with the American. It had mastered the art of using its weapons fearlessly and adroitly, though their precise position and employment had been realised only after several decades of experiment. But it had experimented. Hence we arrived at the conception of central bank duties outlined by Sir Ernest Harvey ¹ in 1928.

THE BANK'S SPHERE OF INTEREST

The Bank of England's internal organisation has been overhauled in the post-War years with a view to coping adequately with modern ideas on close co-operation between central banks. A "Central Banks Section" has been carefully built up, the "Statistical Section" enlarged and even allowed to indulge in the public issue of its Statistical Summary, and Directors who can be claimed to represent economic thought and industry sit in its Court. Directors are to be

¹ See "Central Banks," by Sir Ernest Harvey: London General Press, 1928. The views therein expressed were expanded by Sir Ernest in his evidence before the Macmillan Committee.

found on the board of the Bank for International Settlements, in the formation of which they took a leading part. New York and Washington, Basle and Paris are familiar territory to its predominant directors and officials. European languages have attained a new importance for responsible members of its staff. The American economist lends his orthodox guidance to the higher command, whilst a translated professor of economics is helping to tackle, through two new legal instruments, the Securities Management Trust and the Bankers Industrial Development Company, some of the most intricate problems of reorganisation ever attempted in the cotton, ship-building, and iron and steel industries. This much has the public been allowed to learn about his activities, though assistance and advice may well have been extended to other industries in recent times. Some few years ago the Bank did not withhold support from a large engineering and ship-building group when overhaul and continuation of the enterprise stood out as a national necessity.

Such work of revival and regeneration has by no means been limited to United Kingdom territory, for, realising the major importance of the European market to British exporters, numerous continental countries have been aided in the consolidation and maintenance of economic stability. If May and September, 1931, brought a wind of biting keenness to nip and wither plants so tenderly cherished, it would be churlish to reproach a zealous head-gardener for his arrested culture. He may well claim the onslaught of elements over which he holds

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no conceivable measure of control. Yet, well as he could defend himself on this score, perhaps he may not completely escape criticism for failing to build up his plants to withstand the full force of a blizzard. Some of his beds do not seem to have been properly manured. One bed, his principal charge and centre-piece, should not; perhaps, have had its soil treated with the simple range of fertilising mixtures popular so long ago as 1819 and 1844. Advance and greater understanding should have been achieved in the meantime. But he clung to the proven code of earlier generations of gardeners, well satisfied that the seasonal trend should ebb and flow, yielding a fair average of growth and crops, and seldom shaken by any abnormal blast. All the while the soil has been gently weakened of its finer elements, until finally, in 1931, his garden has swayed and surrendered leaf and branch in the teeth of a searching tempest. His centre bed, with plants of the sturdiest growth, has in truth been shaken and partially stripped. But the roots cling. It is the head-gardener's most profitable patch—his masterpiece, such as his knowledge and ability can create. The stoutest plants will probably survive; the other beds in the garden, as well as the centre beds in most of his neighbourly competitors' grounds, appear at the moment to be in a stricken state. Now he finds himself faced with a searching of thought and experience. Will his former methods suffice to restore the shattered growths, or is a new type of culture called for? Criticism of his former culture abounds, and an almost overwhelming band

of self-appointed advisers has arisen to suggest the new type of gardening which will raise once more the proud heads of his momentarily battered plants and trees, strengthened and unlikely to weaken again to the same extent before a similar storm.

In such a position stands the central bank of Britain. Perhaps the tempest has done useful work in clearing away undertakings in unsound positions, or in eliminating weak features within a given industry. The decline in home purchasing power and the chaotic position of international trading at the present time, however, threaten to undermine firms of the soundest structure. Monetary mismanagement may have had a greater or lesser hand in producing the present position, according to the dogmatic assertions of different schools of economic thought, but the complete breakdown of the gold standard system, as it was known before the War, at once calls into earnest consideration the nature of a reconstructed monetary system—one which ought to be overhauled internationally if possible, but, failing that, renovated at least in the interests of the United Kingdom and its trading associates. In between the old monetary system and the future standard must come what Germans would delight to call a "bridging period." During this time a rationalisation of war payments must take place, a resumption of foreign lending must spring from restored confidence in creditor countries, whilst above all a rise in the general price level at least to that prevailing in 1929 must occur if there is not to be an all-round partial repudiation of national and private debts and a

painful downward movement in wages and salaries.¹ Further, a whole host of exchange restrictions, import quotas and excessive tariff walls will have to be modified. All this may or may not be achieved on Eisleresque lines, or in Sir Arthur Salter's less artificial manner.² Or the elixir proffered by Mr. J. M. Keynes,³ to wit, a Tamurlaine yoking of bold capital expenditure within each leading financial country with an International Note Issue, may yet be granted to contain within it an acceptable means of regaining the world's faded commercial glories. The cynic, however, may well interpose that the usual course of events in all these crises is for the nations to blunder forward by slow steps, arguing and haggling as they go, towards a time of greater economic reason.

THE LIMITED SCOPE OF THIS STUDY

This essay is not intended to cover the methods by which the present imbroglio can be smoothed out. Its scope is the *Sanierung* of the monetary system which is required in order to eliminate danger from insufficient gold supplies and their one-sided use, and from injuriously fluctuating exchanges and price levels. Closer examination may suggest

¹ The Macmillan Committee gave as its opinion that "a large rise towards the price level of 1928 is greatly to be desired." Section 272 of its Report (Cmd. 3897).

² See "This Money Maze," by Robert Eisler, and Sir Arthur Salter's "Recovery," as well as his article dealing with reconstruction, on the leader page of *The Times*, London, June 30th, 1932.

³ "The Means to Prosperity," by J. M. Keynes. Macmillan, 1933.

the possibility of achieving these aims without departing too far from the existing respect for gold movements, and without surrendering the currency to a dangerous form of management which may only too easily be influenced by political considerations.

DRAWBACKS OF THE 1844 ACT

From days before the passage of Peel's Bill in 1844 discussion has waged over the rigidity of the British monetary system. At the time of the acceptance of a gold standard in this country¹ in 1819 monetary arrangements in the chief trading nations overseas stood apart from those in Britain. This country alone worked on a gold standard, and no others took a similar step until the Scandinavian countries and Germany² switched over to gold in the early 'seventies. Portugal, it is true, adopted a gold monometallic standard in 1855, but this was in theory only.³ It could scarcely be described as an effectively functioning standard, as could those instituted in the 'seventies. Not until a growing number of countries moved on to this monometallic basis did the strait-lacing effects of the gold standard

¹ The gold standard was actually introduced in 1816, but the arrangements for a partial resumption of specie payments had subsequently to be withdrawn. The Act of 1819 allowed this resumption on a graduated scale, though full redemption of the note issue in gold was not complete until 1823.

² Sweden and Denmark, 1873. Norway, 1875. (Tate's "Cambist.") Germany introduced it by legislation of 1871 and 1873, but the gold standard did not come into force over the whole of Germany until January 1st, 1876. (Tate's "Cambist," and "The History of Currency," by W. A. Shaw, M.A., p. 215.)

³ See Tate's "Cambist." Edited by H. T. Easton; twenty-fourth edition, 1908.

raise any uneasy stirrings. How a tendency to falling price levels in the 'seventies and 'eighties, arising from a turnover to gold and the relative scarcity of supplies, was countered by the advance of production in the period up to 1914 constitutes common economic knowledge. With a generally upward curve in the price level after 1897¹ the furious bimetallic controversy of the closing decades of the century sank into quiescence.

When crisis descended upon this country, criticism fastened more on the administrative arrangements of the Bank of England than on the fundamental system upon which it managed the currency. Thus Palgrave contended² in 1903 that the strain imposed upon the Bank through watching too closely an artificially narrow reserve in the Banking Department had led to a higher average level of Bank Rate in England during the period 1844-1900 than was really needed by normal trade movements. The Banque de France had not had cause to change its rate nearly so often. The forerunner of modern multitudes, he held "a high range of fluctuation to be a disadvantage to the business man, who must at times be a borrower."³ He did in truth lay part of his gravamen in the unsound arrangements drawn up for the Scottish and Irish banks in the 1844-45 Acts, whereby any seasonal expansion in their note issues beyond statutory

¹ See the chart of wholesale prices (1850-1910) on p. 31 of the Final Report of the Gold Delegation of the Financial Committee of the League of Nations. Geneva, 1932.

² *Op. cit.*

³ "Bank Rate and the Money Market," p. 195.

limits had to be covered pound for pound by gold held in their "principal banking offices." For this purpose gold was drawn from the Bank of England, and the resultant pressure on the Banking Department's Reserve had given rise to too frequent alterations in the rate. This was only a partial cause of complaint, however, for he felt that the whole of the Bank's gold was hemmed in unnecessarily by protective restrictions. Throughout the period from 1844 to 1900 the proportion of the Reserve to liabilities on deposits and bank post bills showed a distinct, though gradual decline. Yet in those fifty-six years the Reserve had become more and more of increasing importance as the backbone of a growing commercial banking structure. Palgrave estimated that whereas liabilities on deposits and bank post bills had increased in the ratio of 100 : 345 between 1844 and 1900, the Reserve had only expanded by the ratio of 100 : 251 during the same period of time. In order to lessen the frequency of Bank Rate changes, as well as to stand up better to foreign predilections for holding highly liquid balances in London, he favoured the amalgamation of the two departments, though at the same time, since the Bank of England did not hold any foreign exchange reserves, he felt that as substantial a gold reserve as possible should always be maintained. Such an outlook exuded Victorian solidity, and Palgravian views on stout nest-eggs of gold counted heavily in the early part of this century, when reserve banking ideas seemed easy to expound and practise if the monetary *status quo* of Europe were

taken as a matter of course. The whole approach to reserve banking was almost static when compared with the dynamics of reserve bank action in recent years. Though gold stocks of comfortable size appealed to the authorities, Palgrave, like Newmarch in 1857, had to be content with beating the air in his plea for unification of the Departments, which would have rendered the gold holdings more accessible in times of pressure.

As it was, prior to 1914 the letter of indemnity had to be addressed by the Chancellor to the Governor of the Bank each time that the official " Reserve " was threatened—1847, 1857, and 1866, though the Act of 1844 was actually infringed only in 1857 by the issue and use of fiduciary notes in excess of their statutory limits.¹ The very rarity of the occurrence, paralleled as it was by less disturbing sweeps in relative price levels than those inflicted upon trading nations since 1914, limited the amount of public attention in this country which was paid to the currency basis during the period between 1844 and 1914 to a small number of sporadic eruptions of controversy ending in negative conclusions. A premature attempt to enlarge the cramping fiduciary issue had marked the year 1873, when a Bill was introduced into the House of Commons² allowing the Bank to issue notes beyond the legal limits in periods of difficulty, providing that " the First Lord of Her

¹ See Andréadès: " History of the Bank of England."

² Introduced by Mr. Robert Lowe, the Chancellor of the Exchequer, as the " Bank of England Notes Act, 1873 " (Bill 191). Reprinted in the *Bankers' Magazine* for July, 1873. pp. 592-3.

Majesty's Treasury and the Chancellor of the Exchequer, after communication with the Governor and Company of the Bank of England, are satisfied:—

(1) That the minimum rate of interest then being charged by the Governor and Company of the Bank of England on discounts and temporary advances is not less than 12 per cent. per annum; and

(2) That the foreign exchanges are favourable to this country; and

(3) That a large portion of the existing amount of Bank of England and other bank notes in circulation is rendered ineffective for its ordinary purpose by reason of internal panic,"

and subsequently give out an order under their own hands permitting the additional issue. The Bill aroused considerable discussion at the time, and it is by no means certain that its general tenour would prove acceptable to present-day supporters of a greater degree of sound flexibility in the British note circulation. The *Bankers' Magazine* for July, 1873, expressed the general feeling as being that the intention of the Bill was unimpeachable, but that it was not effectually carried out in its construction. This publication judged it "to be questionable whether it [the Bill] is not too much fenced about by provisos and limitations as to be weak and rickety, even to the extent of failing itself, as its predecessor has done before." Further, the opinion was offered that the new Bill was drawn too much after the model of the old [1844 Act] and that, in fact, it was based

upon the same automatic mechanism. Sir John Lubbock suggested modifications of the bill in the direction of lessening the rigidity of the set of conditions required before excess notes could be put out, but his proposals only aroused even louder denunciations than those directed against the Bill itself. In any case, Jones Loyd banking respectability still prevailed in sufficient measure to stifle the growth of this infant legislative shoot. Though it was given its first reading on June 12th, it was withdrawn on July 7th, before an opportunity occurred for the second reading debate, and never reappeared in the House. Lowe himself, with his popularity on the decline, shortly afterwards resigned the post of Chancellor of the Exchequer and was sworn in on August 9th, 1873, as Home Secretary. It is interesting to learn from the remarks of the Chairman¹ at the Bank of England's half-yearly general court on the following September 11th that "the Bank's opinion was not really taken on the subject, but the bank was no doubt consulted on some matters, but the bank expressed no opinion on the bill . . . the bank was not called upon to express an opinion." Mr. Benjamin B. Greene, the Chairman, had prefaced these disclosures by remarking that "the Bill has been withdrawn by the Chancellor of the Exchequer, and I think he found it rather impracticable to carry it."

Apart from this ill-planned incursion into currency loosening born nearly fifty years before its time, practically all seemed for the best in the best of

¹ *Bankers' Magazine*, October, 1873, p. 936.

all possible worlds. Even when the bimetallic controversy burst out at its fiercest around 1890 the gold standard soon proceeded to eliminate much of the criticism aroused through a fortuitous development of fresh ore supplies. Only a few voices cried in the wilderness for the suppression of the bi-departmental oddity. Denunciations of existing currency arrangements, however, could draw little support in a period when the gold standard did not palpably misbehave itself. Both Mr. Joseph Kitchen and Professor Cassel have shown¹ by calculations differing but slightly that over the period from 1850 to 1910 the annual increase in monetary gold supplies kept, on the average, a level pace with the expansion of industrial and agricultural pursuits. No monetary centre consciously or unconsciously tended to corner the available supplies of monetary gold. The whole machinery appeared to be running in a divinely automatic manner.

ALTERATIONS IN THE STANDARD ARISING FROM THE GREAT WAR

Then, in August 1914, the lyrical purr of the whole plant faded away at the behest of governments. Scarcely any public safeguard that can be invented appears to be willing to hamper governmental manipulation of the currency—call it defence if you will—as soon as vital danger threatens the State. Automatic working of the note-issue scheme by gold

¹ First Interim Report of the Gold Delegation of the Financial Committee of the League of Nations. Document C. 375, M. 161. Geneva, 1930.

flows vanishes before the intention of using gold reserves to the advantage of the nation owning them alone, and before the needs of national Treasuries. Unofficial gold exports were "hindered," as was the convertibility of Bank of England notes. Ordinary bullion market operations were in abeyance during hostilities,¹ and firms through whom gold exports from the United Kingdom were usually carried out "were unwilling to act against what was considered the general interest for the sake of exchange profit." The convertibility of the Bank of England note issue was not suspended by law during the War, but those who endeavoured to secure note redemption at the Bank were likewise met with an appeal to their patriotism. No legal barrier against the export of gold coin and bullion existed until the Treasury imposed its embargo by proclamation on March 28th, 1919, which was subsequently confirmed by an Order in Council.² This prohibition was to a large extent forced upon the authorities by the fact that the American exchange was decontrolled on March 20th, with the result that the rate quickly

¹ See W. A. Brown Jr.'s "England and the New Gold Standard" (P. S. King and Son), and the article by J. P. Young on "Currency, Credit and Price Movements, 1914-1924" in *Great Britain*, in Vol. I. of the Report of the Gold and Silver Inquiry of the U.S. Senate, 1925. Both these American writers, however, wrongly state that exports of gold coin and bullion from the United Kingdom were prohibited on May 10th, 1917. The proclamation of that date made no mention of gold coin and bullion, though it suspended the export of goldbeater's skin and gold paint containing sulphide of tin.

² *Bankers' Magazine*, May, 1919. This publication added that the belief prevailed in the market that, where special circumstances existed and policy dictated, shipments of gold might still be made from this country under licence.

fell to \$4.50 and opened up possibilities of an overpowering threat to the country's gold reserves. By pegging the pound sterling at \$4.76 during practically the whole of the War period,¹ the Government had held the exchange at a figure which was understood to represent a level reasonable enough to hold back gold exports from the United Kingdom.

It remains extremely likely that in any future crisis which strikes the State this power of currency control will always come under the wing of the Government of the day. The gold standard, therefore, in the most favourable circumstances serves as a "fair" weather instrument of navigation only. Yet, surprising as it may seem, the greatest pains of currency stress were not felt during the actual hostilities. The belligerents strained themselves to the utmost to hold the exchanges and check price rises whilst at war.

THE GOLD STANDARD AND POST-WAR CONDITIONS

The uncertainties and acrobatic instability of price levels in the early years of peace set people's thoughts towards the "beauty and healthy discipline" of pre-War note-issue arrangements. It became a matter of financial sanitation and prestige to contemplate anew a freely functioning gold standard.

Few appreciated the totally different set of economic conditions in which it would now have to

¹ The only occasion when sterling exchange fell below \$4.76 during the War was for a short period in the autumn of 1915, after which fuller arrangements were made to hold the rate.

operate, whilst in other respects the true statistical aspects of gold supplies and requirements have been closely examined only in the most recent years. Financial opinion generally envisaged a British gold standard once more working with the smooth effectiveness described in sections 4, 5, 6 and 7 of the First Interim Report of the Cunliffe Committee. Difficulties of adjusting costs and prices within the countries concerned to those conforming with the level chosen for stabilisation against the gold dollar received scant consideration. The Committee could scarcely be expected to foresee the "unnatural" position which subsequently arose as a result of impossible international debt arrangements and the elevation of tariff walls. But with all due allowance for this, the reports which acted for six years as guiding stars to the bulk of British monetary views stood written as if very little had been learnt, and nothing forgotten, since 1914—or, for that matter, since 1844. To the credit of the Committee, it must be recorded that it concluded that there was no need for an internal circulation of gold coin. This was embodied in the legislation restoring the gold standard in April, 1925. Gold would in future be paid out against notes in the form of bars only, with a minimum weight around 400 ounces each and about £1700 in value. The Currency and Bank Notes Act of 1928, which transferred the direction of the Treasury Note issue to the Bank of England, continued this limitation. British leadership had thus led the way on to the more economical gold bullion standard.

When gold flowed away in appreciable amounts from the Bank after 1925, first to New York in 1928 and then to France in the following year, attention turned more seriously to the need for securing the utmost economy in the use of the world's monetary gold. Other countries, notably France in 1928, introduced the gold bullion standard, or else, like Greece, Estonia and India, adopted a gold exchange standard based on the holding of balances in the gold bullion centres. The general tendency to make use of devises alongside of the metal for holding exchange rates within the gold points added another means of enlarging the volume of trade built up on a given metallic stock. Yet from 1926 onwards price levels were pressing downwards, and the manner in which the United States sterilised gold imports, either through putting gold certificates into circulation¹ or merely increasing the percentage of metallic backing to Federal Reserve notes, decided the trend of prices under a world gold standard. The dollar was calling a deflationary tune of growing unpleasantness in overseas areas pre-eminent alike in financial and trading affairs. France, with her "disturbing" gold attraction over the three years 1929-31 springing from her inadequate conduct of the *rôle* of creditor country on the current balance of international payments, further harried matters on towards the British renunciation of gold in September 1931. Britain for her part sought to follow the upward movement in the value of gold, but for reasons

¹ See Mr. Reginald McKenna's address to the shareholders of the Midland Bank Limited, January 1928.

of politics, as well as through the rigour of the law of contract, found her costs and prices lagging behind gold's killing pace, and her mass of national and municipal debt a burden of increasing weight. The Bank of England could supervise deflationary action within England and combine this "correct" procedure with friendly relations with foreign central banks, in the hope that central bank policy overseas would expunge the necessity for an ever-tightening grip on the volume of banking credit in the United Kingdom. The "sympathetic relations" policy, however, did not meet with the success that might have been wished for—and behind the "need" to deflate British costs and prices in harmony with those of the United States lay the initial handicap of a lack of equilibrium at the starting point in April 1925.

In the stress of this attempt to achieve a dual object—wipe out the handicap and hang on the heels of the leaders—it became increasingly felt that the future issue of bank notes with a 100 per cent. backing in gold metal would repress the extension of credit to many industrial developments which were inherently sound. Credit granted to them would expand national production in a healthy volume. The credit given, it was asserted, would not lead to a rising British price level out of alignment with a stable or declining price level in the United States. British production would at least be enlarged in proportion with the increase in credit, or proportionately, might even exceed the percentage credit expansion. A theory of this nature had as a premise that

British industrial plant had lost little of its efficiency and up-to-dateness compared with that in our overseas competitors, and that British workers still possessed their traditional superiority of skill and their enthusiasm for the nation's trading leadership. Such being the case, ran the argument, an enlarged volume of production could be disposed of in the home market and, more important still, in foreign markets where the eagerness for British quality had not diminished and with which war had not destroyed commercial relations. With expanding overseas sales, because Britain's production had outstripped credit expansion and induced a lower level of prices, it was claimed that British prosperity could develop at the same time as our price level moved parallel with the declining American indices. As events turned out, this would not have been the case for long. Gold climbed constantly in value, accelerating from the middle of 1929. And as commodity price levels fell the real national debt burden inevitably increased, and whether industry were active or stagnant imposed a retarding volume of taxation on business enterprise. The lower prices fell the more stupendous this became—and its payment stood cast about with the full sanctity of legal contract. Yet the straight-forward common sense of the freer-credit idea produced several suggestions just after the War and in the middle 'twenties that a proportionate gold reserve should be maintained, more or less on the lines of the Federal Reserve note issue.¹

¹ See pp. 76-92 for an examination of this type of monetary system.

The "fiduciary" issue could then be altered on the basis of holdings of genuine commercial bills, and would thereby facilitate trade expansion. Presuming that commercial bills formed the predominant means of financing goods transactions, the suggestion was plainly stamped as one placing the interests of the British trading community before an unimaginative desire to sustain a mathematical relationship with American prices, to which the new-old gold standard had begun to drive the British central banking authorities. The proportionate reserve idea marked a healthy break with the "orthodoxy" and mysticism of the 1925 gold standard, but it is doubtful whether it really contained as much relief for industry as its advocates suggested. In operation it would have been found to be still dangerously related to the system it was intended to displace. Declining gold production or a concentration of monetary gold in a few overseas centres could still inflict the pangs of deflation on this country, particularly in view of London's attenuated "official" reserve and her vulnerable position as a large-scale creditor on short term. This would have happened despite an acceptance of the suggestion that contemporaneously with the introduction of proportionate reserve requirements the Issue and Banking Departments of the Bank of England should be merged.

Thus it appears that London would have suffered under a proportionate reserve system in exactly the same way as she did in the crisis of 1931, culminating in the suspension of the gold standard on September 21st. A British percentage reserve system might

even have caused any deflationary defence measures on the part of the Bank to be more stringent than they were. As each £1 of gold was exported from Britain the note issue might have had to be contracted by nearly £3 under a 33½ per cent. gold reserve requirement—assuming that the metallic backing actually held were close to its legal minimum, as in point of fact it would have been.

These suggestions did not attract a widespread measure of support as the system creaked to its disintegration in a welter of gold mismanagement, dwindling international confidence and political scares. London's position became jeopardised through foreign mistrust arising from the Budget position in 1931. With the current balance of international payments in that year pulling the pound down, foreign opinion had already become sufficiently apprehensive. Gold price levels continued to gallop downhill at a rapid pace, the American wholesale¹ index (year 1913 = 100) declining from a monthly average of 110·3 in January 1931 to 100·6 in August of that year. Sterling was finding the pace too hot, though the British Board of Trade monthly index of wholesale prices fell from 106·9 to 99·5 (year 1913 = 100), or by 7 per cent., in the same period. The national debt burden for a number of years had formed a fearsome proportion of the expenditure in successive Budgets, as the following figures reveal :—

¹ U.S. Bureau of Labor Statistics.

REVENUE AND EXPENDITURE OF THE UNITED KINGDOM, EXCLUDING SELF-BALANCING ITEMS

(£000 omitted.)

Year to March 31.	Ordinary Revenue.	Interest and Management of National Debt.	Allocation to Sinking Fund.	Total National Debt Service.	Total Expenditure (including Sinking Fund).	Percentage of National Debt Service to Total Expenditure (including Sinking Fund).
1924	773,268	307,309	40,000	347,309	784,939	47.9
1925	733,493	312,161	45,000	357,161	729,834	48.9
1926	740,657	308,229	50,000	358,229	754,695	47.5
1927	733,428	318,584	60,000	378,584	770,122	49.2
1928	766,358	313,816	65,000	378,816	762,119	49.7
1929	758,104	311,491	57,509	369,000	739,709	49.9
1930	734,189	307,232	47,748	355,000	748,712	47.6
1931	775,895	293,170	66,850	360,000	799,171	45.0
1932	770,963	289,492	32,508	322,000	770,599	41.8
1933	744,791	262,305	46,195 ^a	308,500 ^a	777,070 ^a	39.7

^a Including the payment of £28,056,349 to the U.S.A. Government on December 15, 1932. The British Government reserved the right to treat the whole of this sum as a capital payment of which account should be taken in any final settlement. (Cmd. 4215 and 4217, of 1932.)

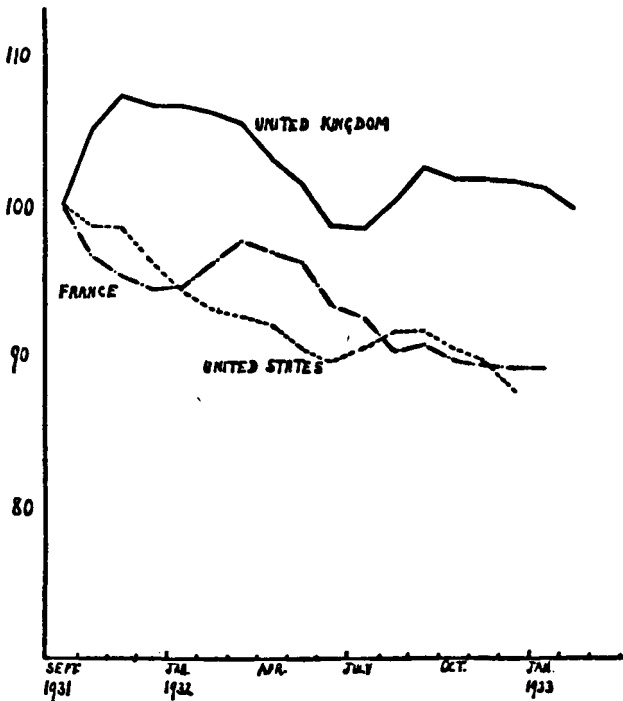
Critical observers abroad found it difficult to overlook this continuing drain on the yield of British taxation, and their apprehensions were aroused when revenue was obviously not coming in during 1931 in accordance with expectations. Coupled with this unsoundness, London's all-powerful international banking interests were at length believed to have entangled themselves in the growing financial and trade stagnation of Europe. Too many foreigners with short-term money in London had faith that was prepared to be shaken by anything. Instantaneous readiness for a grand *sauve qui peut*

characterised the floating mass of international short-term money. But the ship lurched, and foreigners, believing that even the Navy would fail it, abandoned what they thought to be a sinking vessel. Credits totalling £130 millions, which were hastily arranged by the Bank of England and the Treasury, availed little, and were absorbed almost entirely in attempting to check the foolhardy stampede of foreign capital out of Britain. France, Switzerland, Holland and the United States seemed safer refuges, even if only microscopic rates could be earned on balances in those countries. For the moment the idea was held abroad, and in none too deep-thinking political quarters at home, that Britain had lost financial caste. She had failed to live up to the prestige attached to those clinging to a respectable gold standard. Her pre-eminence had gone until such time as she could once more enter the orbit of the world gold standard. Management and disastrous inflation were believed to be near at hand. Events have proved otherwise, and it can be observed that the sterling wholesale price level¹ could remain more stable in the period since the end of August 1931, during which a comparison of the Board of Trade indices for September 1931 and January 1933 showed a rise of only 1.1 per cent., than in gold standard countries,¹ the wholesale price levels in France and the United States having fallen respectively by 10.9 and 14.3 per cent. in the same period. The wholesale price index figures used have been calculated on the basis of 1913 = 100. The

¹ Statistics from *League of Nations Monthly Statistical Bulletin*.

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WHOLESALE PRICE LEVELS SINCE SEPTEMBER, 1931.
(SEPTEMBER 1931 = 100)



FIGURES FROM BOARD OF TRADE JOURNAL, NOV. 17, 1932, AND
FROM STATISTICS DEPARTMENT, BOARD OF TRADE.

general trend of price levels in the United Kingdom and gold countries can be compared in the chart on p. 34, in which the monthly average wholesale price level for the starting point of September 1931 has in each case been taken as equal to 100.

Britain had in actual fact freed herself from a metal's tyranny and given one of the first two leading demonstrations in world monetary history that currency management, regardless of gold stocks held, was not necessarily a dangerous evil. Is it an experiment which will lead the world on to greater economic tranquillity? The answer depends on the use far-sighted minds in government and central banking circles can make of the opportunity now spread before them.

CHAPTER II

PROBING THE GOLD PROBLEM

THE GOLD DELEGATION'S FIRST INTERIM REPORT

It is almost ironical that as the gold standard based on classic stipulations hastened to its dismemberment, a Gold Delegation of the Financial Committee of the League of Nations conducted an investigation which affirmed ultimately in its final majority report (June 1932) the excellence of the failing idol, provided it was slightly patched up.¹ Its First Interim Report (1930) gave few hints of the orthodoxy that was to come in the Final Report. In fact, the statistical studies contained in the first volume, and the obvious deductions, gave hope that something helpful would emanate from its deliberations, the unanimity of which might lead nations to overhaul their gold standard apparatus in a manner that would go a long way towards checking permanently monetary faults which had aggravated the economic difficulties of the post-War period. Its terms of reference had been "to examine into and report upon the causes of fluctuations in the purchas-

¹ The Reports of the Gold Delegation were issued in this country by George Allen and Unwin, the official agents for League of Nations publications.

ing power of gold and their effect on the economic life of nations." There was no specific call for recommended changes in gold technique. Despite this, something more had been expected from the Delegation than the static outlook which stamped its conclusions. It appears to have shirked the really constructive thinking which could have been done after surveying an unrivalled display of material from the world's experts.

Early in the Interim Report it betrayed its distaste for original currency development by outlining some of the guiding ideas with which its task had been approached. Most disturbing among these was that "it has been assumed that the demand for currency is dependent upon the volume of production and trade and on the monetary transactions to which such trade gives rise, and that, *in the absence of any important changes in currency systems and practices*, the demand for gold will be determined by the same factors." The italics are mine. Precisely because nations had become disturbed over the available gold supplies had they begun to coquet with the idea of changes in technical arrangements under the standard. By making the unjustified assumption already quoted, all advance, beyond obvious suggestions which might prolong the smooth operation of the gold standard for a few years more, had been ruled out by the Delegation. Now that the system has started to wane it is time that attention was directed not to its efficacy merely over the next ten or perhaps fifteen years, but over the longer periods running for at least fifty years, or into the next

century. The existing generation of youth has no desire to be caught up in another depression of a magnitude comparable with the present. Something more is expected of their seniors than to tinker feebly with this vital instrument of modern life, batten it once more in an unreformed state on the body economic, and then sink in fifteen years' time into their graves, leaving their juniors once more enmeshed in the toils of declining relative gold supplies because a task had been scamped and deferred in the early 'thirties. The elder central bankers ought not to "get away with it." Sooner or later, on the Delegation's own statistics, reorganisation of the standard in the direction of a greater degree of management has got to come. Samuel Jones Loyd died fifty years ago, and his ghost might quite easily not prove so dogmatic and conservative as the modern counterpart of Lord Overstone's school, could he but air his views to-day after perusing the data now at our disposal. Pre-War conditions have gone for ever, and adjustments to existing facts are urgently called for. At the same time, it must in justice be recognised that the "facts" of the immediate future of gold supplies may not be so full of threats as a number of apprehensive economists would have the world believe.

The Delegation concluded that the likelihood of further gold discoveries on a large scale is remote. Economies can be obtained through the cessation of gold coin circulation and the lowering of reserve ratio requirements against notes and sight liabilities. Further help in prolonging the workability of the

pseudo-automatic system would come from an extension of banking and cheque-drawing habits in a number of countries. Apart from this, the return of confidence which would come from the abolition of abnormal trading controls and from war debt trimming, leading on to a normal functioning of international capital movements, would, it states, ultimately restore the blessings of an immaculate gold standard era. Intelligent co-operation would surely then provide for an optimum distribution of the available gold. But before any of the delights which flow from the simple ecstasy of this state of affairs could accrue, the Delegation granted that there would have to be a substantial rise in world price levels.

ESTIMATES OF THE FUTURE ADEQUACY OF GOLD SUPPLIES

Economies of the nature described may well lengthen the period of workability of the gold standard in the Gallic sense. Further, the authoritative calculations of annual increments of gold to the world stock which would be required in order to maintain price levels stable on the average over a period of years probably over-state the amount. Cassel¹ compared the years 1850 and 1910, because the general levels of prices for those years were the same. He found that the average annual addition to the world's *total gold stock* over the period took place at the rate of 2.8 per cent.

¹ See First Interim Report of Gold Delegation.

In addition, he felt that 0.2 per cent. per annum should be added to allow for wear and wastage, making a 3 per cent. increase in all. At the same time he estimated that the general run of European countries expanded their combined industrial and agricultural production at the rate of approximately 3 per cent. per annum during the sixty years. Kitchin carried out a similar investigation, and calculated that an average annual addition of 3.1 per cent. to the world's stock of *gold money* would be required in order to maintain commodity prices stable as far as their trend was concerned.

Cassel admitted that gold coins do not now generally circulate, and that since gold has for the most part been locked up in bank or Treasury vaults his allowance for wastage might over-state actual requirements.

The main figure of increase has been based on an 1850-1910 type of need. In this period other great trading nations besides the United Kingdom were moving on to the gold standard and building up stocks of the metal, with the result that solid and substantial gold holdings became an indicator of the national wealth. This solidity and substance would not now be called for in the finest type of advanced gold standard. Gold holdings, as the Macmillan Committee has emphasised,¹ should nowadays be called into use only for the readjustment of temporary unevenness in the balance of international payments. If the standard were

¹ Report of the Committee on Finance and Industry, 1931 (Cmd. 3897), para. 340.

operated on this principle, while wise control administered the volume of fiduciary circulation put out in accordance with statistical measurements of the trend of economic development, there would already be an ample supply of monetary gold in the world. The only thing lacking at the present time would be its optimum distribution; this, however, the Delegation hoped would ultimately be secured.

Since Cassel's and Kitchin's figures may conceivably over-state the required magnitude of the yearly increase in monetary gold stocks, it would be unwise to be too dogmatic as to the amount necessary. For this reason, the Delegation made its calculations reflecting the adequacy of ore supplies on the two figures of a required increase of 2 per cent. and 3 per cent. per annum. To adduce everything that can be said in favour of the "old" gold standard, one must be prepared to accept the results of a 2 per cent. calculation as nearer the mark. But another major complication in assessing the beneficial life of the mines should be given its due weight.

Most countries on the standard have stipulated by law that the note-issuing authority must maintain a proportionate reserve of gold against the note issues and deposit liabilities, the figure generally being around 30 or 40 per cent. High as these requirements are, it was found that in practice note-issuing banks preferred to work with a ratio some distance above the minimum and, in fact, to regulate their credit policy according to the growth of "danger" as the ratio fell close to the legal minimum. The harm contained in this lay in the fact that the gold

represented by the 30 or 40 per cent. legal minimum constituted a useless barren asset; it was not to be touched. Any use of it to smooth out a larger unevenness than usual in current international trading relations at once raised cries of alarm. The monetary structure of the country concerned was believed to be crumbling. Credit restriction rushed to its salvation. Not that some measure of restriction may not have been desirable if an unhealthy situation was in reality tending to develop. But the loss of gold through excessive short- or long-term capital withdrawals, or abnormal non-commercial debt payments, could offer no sane justification for adding to the difficulties of the trading community by deflation. Still more foolish would this appear if note issues expanded to meet genuine commercial expansion, while at the same time a country's gold stock stood still as a result of insufficient gold production or an inadequate distribution of the available world output of the metal. The ratio would decline. Danger would be sniffed by orthodox noses—yet all the while nothing but perfectly praiseworthy endeavour was expanding in the business world.

Both the Gold Delegation and the Macmillan Committee have recognised that considerable scope exists for a reduction in the effective minimum ratios. More can be achieved in this direction than the Delegation appears to envisage. At the date of its Interim Report (summer 1930) it found that in the case of all the central banks which could be brought within its purview the average legal reserve requirement against sight liabilities came to 32 per cent., of gold, though

whenever possible these banks aimed at maintaining an average reserve of 40 per cent. in gold. No advance has in practice been made with regard to ideas concerning gold reserves over the space of a hundred years. In 1832 the then Governor of the Bank of England testified ¹ before a Committee of Inquiry that the Bank habitually held reserves of 33½ per cent. in bullion and 66½ per cent. in securities against the note issue. The reserve of one-third in bullion appeared to him to be "about the proper proportion, with reference to periods of a full currency." When the Committee pointed out to him that the Bank, in view of the circumstances in which it was placed, kept a larger reserve than it would if it functioned merely as an ordinary commercial bank he agreed, adding that "it had to be prepared to uphold the country circulation." In addition to that duty, it normally expected to be called upon to meet a drain arising from exchange movements, as well as to satisfy the needs of timid men within the country who demanded gold in an emergency. And yet with the spread of gold bullion standards the modern world still clings in practice to Mr. J. H. Palmer's figures on 1832. Truly, our forefathers must have been far-seeing.

In view of the present high range of reserve ratios, an unhappy prospect stares puritanical gold countries in the face, failing a lowering of the legal limits as the Delegation suggests. Allowing for the non-

¹ See evidence of Mr. Horsley Palmer before the Committee of Inquiry into the Renewal of the Bank Charter (1832): Parliamentary Papers, 1831-2, Vol. VI.

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monetary demand on world production the First Interim Report found that if an average cover of 33 per cent. were maintained against notes and sight liabilities combined, whilst an increment to gold reserves at the rate of 2 per cent. per annum sufficed to hold price levels stable as trade grew, then a deficiency in the additions to gold reserves would be felt in 1938 and subsequent years if no reorganisation of the gold standard had been undertaken before that date. The world would then tend to move into an era of declining price levels—perhaps not so precipitous a fall as in the past two years, but nevertheless a continuous sapping at the stability of political and social relations and the rules of commercial contract. Every weakening of the capacity of debtor firms and countries to dispose of their products at remunerative prices—prices which bring a fair return to investors who have financed them—will tend to diminish the economic power of this country. The total British overseas investments have been estimated by Sir Robert Kindersley¹ at £3,724 millions at the end of 1930, of which approximately £1,437 millions were in government and municipal securities and probably £2,287 millions in business undertakings. In 1929 the net income from these, estimated at £250

¹ *Economic Journal* for June, 1932. Kindersley's actual figures were: Foreign and colonial governments and municipalities, £1,437,339,000; Companies registered in the U.K. and operating abroad, £1,204,764,000; Companies registered and operating abroad, £782,534,000. In addition, he considers that another £300 millions should be added in to account for British investments, mainly private, in foreign securities, and for other forms of British investment overseas not examined in detail. I have assumed that the £300 millions would be invested mainly in business undertakings.

millions by the Board of Trade,¹ served to meet 65·6 per cent. of the deficit which was shown on visible trading account by this country in what must be accepted as the nearest "normal" year. In the absence of an extraordinary expansion in the demand for British shipping, banking and insurance services on the part of foreigners, a remote contingency at a time when these lines of work seem compelled to look mainly to concerns and countries in which British capital predominates to set them in motion, then a lowering of the standard of life in this country would appear inevitable. Our diminished dividend and interest receipts from abroad would hamper our ability to cover the cost of our vast bulk of merchandise imports. At the moment it scarcely seems likely that a growth of British exports on a large scale would come to our rescue by increasing claims on abroad on goods account in a period of falling or depressed prices. For a time it would undoubtedly be possible to fill the gap left uncovered in the British balance of international payments, as a result of dwindling interest and dividend receipts from overseas, by realising foreign investments. But such an action merely stores up further trouble for the future, and brings on the day when the United Kingdom may be a second-rate business and financial power. It will be recognised that the whole set of circumstances would resemble those which arose in 1931 and which still strain to hold us in thrall. So far, however,

¹ *Board of Trade Journal*, dated February 18th, 1932, which contained a revision of some of the statistics published in the Macmillan Committee's Report, Appendix IV, p. 305.

thanks to the faith which man has not yet surrendered in the wisdom that may descend on politicians and monetary authorities in a fairly near future, there has not been any serious inclination to accept prevailing conditions as other than temporary and unprecedented. Improvement is hoped for, because of, or despite, fiscal measures taken to quicken the advent of brighter days.

The decline in world price levels from 1938 onwards which would ensue from the Gold Delegation's most favourable calculation in the Interim Report would offer the first permanent and long-drawn-out danger. Its other estimates were even more threatening. Assuming a 40 per cent. cover for notes and sight liabilities, and a required annual increment to gold reserves of 2 per cent. in order to hold prices steady, the deficiency of metal supplies would start in 1934. With a 40 per cent. cover and a 3 per cent. annual increment the deficiency years are already upon us. Both of these latter probably represent extreme statements of imminent dangers. Economies, chiefly in the form of lowered ratios, are bound to come.

THE FINAL REPORT OF THE GOLD DELEGATION

Indeed, in its Final Report, to which were attached important dissenting memoranda by some of the outstanding members of the Delegation, the more apparent gold-saving devices were stressed, without too fundamental a severance of faith in the gold standard. Tinkered about and patched up in the

direction of lowered reserve ratios, the popularisation of cheque payments, and the substitution of token coinage for smaller notes, the gold standard, it was asserted, could still remain "the best available monetary mechanism." Granted, of course, that the trading and exchange restrictions now shackling the world had been considerably modified, and that abnormal money payments across frontiers had been adjusted to amounts which could be transferred with greater ease. Wholesale commodity price levels existing in June, 1932, were recognised as impracticably low for the stabilisation of currencies against gold, and a rise was described as "desirable" before the principal commercial nations could be expected to approach agreement on gold standard working without apprehension.¹

This orthodox scheme of repair by somewhat unimaginative minds allowed for the fact that gold supplies would probably be available in adequate quantities for a longer period of time than their Interim Report figures promised. Yet an ostrich-like obstinacy towards the facts of gold supplies and their probable utilisation over the next hundred years stamps their counsel. They yearn for the re-creation of days when gold movements will bring healthy discipline and be permitted to work themselves out in their full draconian manner, reforming, chastising, enervating and quickening as bricks and ingots are passed to and fro in ownership. Caution of the most academic kind is to characterise all advance. Thus, reserve ratios ought to come down,

¹ Section 176, p. 47 of the Final Report.

but only by prior international agreement, in order to minimize the shock for an unsophisticated world. As for abolishing the system of legal minimum reserve ratios, such an action is roundly castigated as not practicable or advisable. But Janssen, Mant and Strakosch were not deterred from their dissent. It must be granted that the mainspring of the "quasi-unanimous report" lies in a desire to see a restored volume of international trade fertilising world growth and advance, for which purpose the signatories felt that, after the initial regularisation of debts, prices and the terms of the standard, the most helpful factor would lie in the stability of exchange rates. They could not conceive of "management" of currencies contributing to this, though any deep exploration of the nature of management appears to have been overlooked by them. Circumscribing the area of exchange fluctuations dominated their minds, to the extent that upward and downward swings of price levels were implicitly accepted as healthy tendencies in a society striving to benefit from the virtues of reasonable competition.

THE NOTE OF DISSENT

A number of members, however, preferred to lay emphasis on a different set of monetary aims, besides putting forward a more comprehensive interpretation of the facts leading up to the present derangement of the gold standard's universality. Their pens appear to run with greater political freedom. Not only do they touch more outspokenly

upon government policies which have undermined the standard in addition to its own managerial shortcomings, but they find it necessary to suggest a more thorough-going overhaul than does the main Report, and even indulge in an ominous aside as to the length of the time required before order, normality and reason will return to allow the gold standard to operate once more without undue friction.¹ But attachment to the old retainer lingers on, and they cannot bring themselves to discharge him and engage his nephew so long as the majority of people accept his unctuous respectability and "tried" capacity, despite a certain crotchetiness at times. Perhaps he can be gently drugged into more affable moods!

Sir Reginald Mant, Sir Henry Strakosch and M. Albert Janssen attached their signatures to a lukewarm general report, and then proceeded to submit a note of dissent which in itself could have justifiably been presented as the quintessence of the whole Delegation's deliberations. In their view the standard broke down as a result of the precipitous decline in price levels, which arose from the insistence upon payment of unnatural reparations and war debts, "combined with the unwillingness of the receiving countries to accept payment in goods and services, so that payment had to be made in gold," whereas the principal Report had been at pains to skim quickly over this topic. Leaving aside differ-

¹ The majority report had admitted that "it is conceivable that the complete process of restoration, if and when it is decided upon, will take a prolonged period to effect" (para. 77, p. 23).

ences on this point, the three dissenters stressed that stability in the general level of wholesale prices should be the prime objective of monetary policy. They cannot share enthusiasm with the main Report over the quickening benefits of price levels fluctuating as industry expands and flags around the normal trend of progress. Stability would lead to a more tranquil development in the economic and social sphere, thereby eliminating the abrupt or insidiously weakening adjustment inherent in a sergeant-major type of gold standard. But as so much of the whole system is at present out of gear, prices will probably have to be brought back to the 1928 level at least, in order to harmonise the interests which have now fallen victims of a set of circumstances un contemplated when contracts were signed and agreements drawn up. Having arrived at the haven of the 1928 price level, the dissenting memorandum declares for a gold standard, since "the restoration of that standard is probably more likely to be acceptable to the nations as a whole than the adoption of any other system." Before this step can be generally taken by nations, a number of conditions must be fulfilled by the high contracting authorities. As the main Report insists, international trade must be proceeding at a more normal rate, whilst reparation and war debts must be settled in a manner which renders the terms capable of fulfilment. A world agreement providing for the utmost economy in the monetary use of gold should be drawn up. With this end in view, the legal provisions for minimum percentage reserves of gold against notes and sight liabilities

ought to be completely abolished, since internal drains of gold are unlikely now that the gold bullion standard has been accepted in the monetary practice of the leading nations. Gold's principal use has now become the meeting of current deficits in the balance of international payments. The restored standard could nevertheless not work smoothly unless the "rules of the game" were outlined and accepted in spirit and in fact by the countries concerned—gold movements must produce inflationary or deflationary consequences, and no country must indulge in unnatural accumulations of the metal. Our three dissenters are hard-headed enough to grant that any abnormal strains in the future similar to those experienced in recent years would speedily destroy the efficacy of the gold standard. Their readers are left to speculate whether mankind is really on the verge of an enticing "promised era" of monetary advancement and world-political teamwork.

But the ingenuous hopes of Mant, Janssen and Strakosch are not entirely exhausted. Given the above pre-requisites, they feel that the nations of the world should be able "to accomplish a more reasonable distribution of the world's monetary gold supplies, provided, of course, that the present political causes of maldistribution are removed." And so, to cap all, they conclude that "thus the way would be paved for the restoration of an international gold standard." Like the principal Report which they extend, no indication is offered of the length of time over which gold supplies would suffice, bearing

in mind the results of the fresh economies they desire to introduce. Could one contemplate an out-and-out acceptance of every item in this dissenting declaration of monetary ideals, it might well be granted that there was already a supply of monetary gold in existence which would be adequate for at least a century or two. Yet the danger of a leakage in the confidence and faith on which the system will rest can never be dismissed in a somewhat intractable world. Further, apart from the durability of the system *qua se*, the period of education and kindly induction into the new era appears unlikely to be short in the world of existing facts. Thirty or forty years may even under-estimate the time required, at the end of which Jacob's service mankind cannot be too sure that it will receive a virgin Gold Standard whose affection and loyalty will remain constant for many decades. Hopeful as they appear to be, the three dissenters acknowledge that they "would only go so far as to say that the gold standard is the best available mechanism *if properly managed*." Management therefore remains the crux of the problem. The absence of consideration of alternative methods of management stands as a blemish on the Reports, since it is in this direction that an important volume of monetary thought is tending to turn.

While dipping into the Gold Delegation's Final Report as a hallowed study of monetary ideals, it may yet be possible to fashion a system derived from a parent standard which entered senescence after the Great War and scarcely seems likely to

enjoy eternal life. This new standard may not represent the purest of monetary structures, in the sense of an all-embracing scheme, but its operation could fit in better with the conflicting factions of mankind. After all, the Delegation itself almost offers a fingerpost to a reconstructed form of the gold standard. The beginning of its conclusions avers that "the gold standard is not a fixed and rigid mechanism, but a system of monetary and credit policy which has gradually developed in the light of experience and has adapted itself to the needs of changing economic conditions." This standard has failed the world in recent years, but the Delegation submits no practicable method of escape from its fundamental dangers. Great Britain flung defiance at its shackles, and should her action be followed up by action along the lines of a suggestion in the dissenting report that "off gold" countries ought to collaborate to hold internal price levels stable, so leading on to "the ultimate stabilisation,"¹ it may well be found that some of the more advanced financial countries are groping their way almost unwittingly on to a less treacherous type of permanent standard. The three dissenters recommended that "off gold" areas should adjust their wholesale price levels upward to points reasonably compatible with wage-rates and debt charges. Upon achieving this, it appeared to them most feasible to maintain exchange stability against the pound sterling, while at the same time the United Kingdom, working in close understanding with countries

¹ Note of Dissent, p. 72.

" tied " to her currency, would particularly concern herself with maintaining stability in an equitable cohesiveness of wholesale prices, wage and debt charges within her own borders. Yet all this adroit manœuvring is intended to be but " the best way of preparing the ground for a general return to the gold standard," of the finest ethical type as already outlined. It does not occur to the three that whilst " holding " price levels and exchanges the authorities in the benefiting countries may acquire experience in smoothing the operation of a fresh type of monetary mechanism. The leading monetary centres which undertake this may be unwilling to discard any of that experience when the nature of a " long-term " monetary standard comes to be discussed after the economic cleansing called for by the dissenting members of the Gold Delegation has taken place.

A danger exists that this process of repair may take so long that a number of countries will begin to press for a reversion to a " steadying " form of gold standard, and will secure its introduction before world conditions would justify the experiment. The " international understandings " and " agreements " —assuming that they can be brought into being— may then prove insufficiently water-tight for the system's durability. Hasty renovation will therefore merely postpone for a limited period a fresh series of difficulties, if not another disastrous *impasse*.

DRAWBACKS OF THE REPORTS

But the question arises whether an experiment along either of the Delegation's ideal lines would be feasible or desirable in view of the members' failure to consider adequately the actual facts of gold supplies and demands. This part of their deliberations should have received much fuller statistical investigation. It would, for instance, have been illuminating to know for how long they or their experts estimated that gold supplies could meet the monetary demand without tending to depress price levels if reserve ratios against note and sight liabilities were universally reduced to twenty per cent., whilst at the same time the gold content of all the standard coins were diminished by one-third. Estimates founded on different combinations of these two possible reductions (quite apart from the likelihood of securing general agreement to undertake them) would have furnished still more valuable material for those who will have to sit in ultimate judgment on the choice of monetary systems. And, to repeat, no generosity of treatment was accorded the possibilities and mechanics of "Management." In this connection the British abandonment of gold in September, 1931, provided, it is to be hoped, another landmark in world monetary history. It must not be forgotten that Britain led the way on to the gold standard in the period 1816-1823, and that all the other countries which subsequently followed that step, among which were some that now exalt the standard in their favours and eye its critics with

offended stare, required at least fifty years before discarding their bimetallism, *étalons boiteux*, silver or inconvertible paper systems in favour of the yellow metal.

There therefore appears no reason to assume that this country should be classified as lacking in beneficent monetary leadership. It should not be taken for granted that one of the foremost trading nations, which introduced a currency system that even its most critical opponents agree proved a reasonably satisfactory servant for a whole community of nations in the thirty years preceding 1914, must keep step in its monetary ideas with those of slower economic wit in nations less vitally interested in the maintenance of foreign trading activity. A mass of doctrinaires still clinging tenaciously to the main lines of their economic instruction in the pre-War period, as well as those afflicted with peasant-mindedness in gold standard affairs, ought to be swept aside in progressing towards a more rational direction of monetary systems. In no country does more scope or opportunity exist for that advance than in Great Britain.

CHAPTER III

THE BRITISH GOVERNMENT'S PRESENT POSITION

SINCE the suspension of the gold standard in September, 1931, the British Government has taken care to refrain from committing itself to any specific set of plans for a reconstruction of the national currency system. No statement by an official spokesman has yet pledged it to return to the gold standard, whether of the pre-suspension type or of the nature outlined in the main League Delegation Report or in that of the three dissidents. It retains an open mind until such time as a greater degree of international political and economic tranquillity will enable it to point its course to the enduring advantage of Commonwealth trade. Hence, it is entitled to declare in favour of bimetallism, "reformed" gold standards, managed systems (including a "compensated" pound), symmetallism, or even a silver standard should it so choose. The Chancellor has remarked that perhaps he might eventually decide that gold—"reformed," of course—offered the most suitable instrument of currency regulation, but whenever taken to task in the matter of committal, he has hastened to reaffirm that complete freedom of action remains with the

necessity for a rise in price levels, but their Report¹ emphasised that such a rise cannot be brought about by monetary action alone. Recognising the great importance of stability of exchange rates over as wide an area as possible, the Conference took note with approval of the fact that the United Kingdom had declared itself in favour of avoiding wide day-to-day fluctuations between sterling and gold. But no declaration came from the united body of delegates in favour of one particular monetary standard which they ought one and all finally to adopt. It was declared that the Conference refrained from making any recommendations on the subject, in view of the fact that the question is shortly to be discussed at an international conference, *i.e.* the World Economic Conference. Some divergence between the viewpoints of Canada, South Africa and the United Kingdom doubtless counselled a generalising evasion rather than a hasty tackling of this problem. Accordingly, the Conference "recognised that the ultimate aim of monetary policy should be the restoration of a satisfactory international monetary standard." Gold, it should be noted, is not named. The wishes of Commonwealth countries were that they should co-operate with other nations, and that the standard chosen "should so function as not merely to maintain stable exchanges between all countries, but also to ensure the smooth and efficient working of the machinery of international trade and finance." It

¹ See "Appendices to the Summary of Proceedings of the Imperial Economic Conference" (Cmd. 4175).

therefore appeared to them that this postulates international agreement among the great trade nations of the world, for international co-operation furnishes the fullest means of avoiding, "as far as may be found practicable," wide fluctuations in the purchasing power of standards of value. While pointing out that a rise in the price levels of gold countries would provide the most expeditious means of adjustment to existing levels of national and private debt burdens and wage rates, besides bringing a new impetus to international trade if it were coupled with other alterations of a non-monetary kind (presumably changes in tariffs, import quotas and exchange restrictions), the Report noted an agreement that countries within the Commonwealth whose currencies are linked to sterling should maintain stability between their own exchange rates. Though a rise in the general level of wholesale prices was eminently to be desired, it should be assisted by an orderly monetary policy, and not by wanton and inflationary financing of public expenditure by governments. To sum up, however, the Ottawa conclusions offered scarcely more than guiding generalisations, for no loose, let alone closely-knit, scheme of imperial currency arrangements was outlined as a result of these deliberations.

THE ANNOTATED AGENDA FOR THE WORLD ECONOMIC CONFERENCE

Early in 1933 the committee of experts preparing the agenda for the World Economic Conference had

to contend with this cautious and distant contemplation of the gold standard by the British Government. Sir Frederick Leith-Ross, the British delegate, is understood to have expressed his Government's profound interest in any steps that might be taken by countries still on the gold standard to secure an enduring degree of workability for the gold system. It is obvious that the United Kingdom would strain its utmost to work with them towards the goal of stable prices and steady exchanges. As he is reported to have insisted, the solution of their common difficulties demanded an earnest examination of reforms that could be grafted on to the gold standard. Great Britain could grant that much without tying her own hands. Further, another point to be discussed in this connection would be the necessity for granting increased legal powers and independence of politics to central banks. Stating his Government's viewpoint with deliberate restraint, Sir Frederick is known to have mentioned that a settlement of four important groups of problems would have to be achieved before the world could hope to move into an era of less troubled economics. These comprise :

- (1) A settlement of war debt disputes.
- (2) The stabilisation of national currencies.
- (3) Removal of trade barriers, such as excessive tariffs, import quotas, and root and branch systems of foreign exchange control.
- (4) The raising of commodity price levels.

The gist of his remarks can be readily understood

in this country, even if there be others abroad who may be somewhat zealous to leap in and misconstrue their meaning. It can be taken as this : that it is easy to contemplate a satisfactory gold standard *in theory*, perhaps along the lines of the Mant, Strakosch and Janssen Report ; but that before it becomes a concrete reality there exists a whole host of worldly matters to be disposed of. The United Kingdom cannot afford to hold back from all endeavours to ease the economic and political strain on nations, nor in all justice can she withhold her co-operation in exploring the possibilities of working the gold standard on new and satisfactorily effective lines. But it would be difficult to interpret Sir Frederick's remarks as a declaration of irrevocable attachment on Britain's part to the gold standard. At the present stage in the discussions both the British Government and their delegates must be granted credit for their experience as negotiators. So many provisos have been uttered that British freedom of action remains.

The annotated agenda¹ drawn up for the full conference by the preparatory committee of experts, which was published on January 19th, 1933, fully recognised this British contention that the question whether a more universally adopted monetary system could be accepted under a given set of conditions by any particular country was a matter for the independent decision of the country concerned.

¹ Issued in this country by George Allen and Unwin, Ltd., the official agents for League of Nations publications.

When touching upon monetary and credit policy as one head of discussion for the Conference, the preparatory committee wrote :—

“ In the field of monetary and credit policy, the objective must be the restoration of an effective international monetary standard to which the countries which have abandoned the gold standard can wisely adhere. Each Government must, of course, remain free to decide when, and under what conditions it could adopt such a standard, and we do not suggest that this can or should be done without the most careful preparation. The notes appended clearly show that there are a great number of economic as well as financial conditions which must be fulfilled before the restoration of an international gold standard can be a practical possibility. Moreover, it will be necessary to provide effective safeguards against such a restoration of the gold standard leading to a fresh breakdown. The question has to be considered whether measures can be taken, with the co-operation of central banks on the lines of the recommendations in the Report of the Gold Delegation of the League of Nations, to ensure a greater stability of price-levels in the future.”

In the summarising document, therefore, British hands remain unfettered. The Government has preserved the right to enter the full World Economic Conference, whether it be held in May, June or July, in a position which enables it to give a remarkably strong lead on monetary questions. On the other hand, the Government may choose to withhold its hand in this matter of a sterling stabilization, urging that some highly important desiderata for monetary equilibrium have not yet been remedied by other countries, and that Britain has no wish to

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contract for the purchase of a currency pig in a Washington or Parisian poke.

In fact, the experts who prepared the agenda did not burke the task of pointing in clear terms to those conditions which must prevail if the possibility of restoring a free gold standard has to be considered. To a large extent their recommendations follow the lines of the League Gold Delegation's Final Report blended with that of Mant, Strakosch and Janssen. Among their suggestions and dicta of paramount interest are the following :—

“ The time when it will be possible for a particular country to return to the gold standard, and the exchange parity at which such a return can safely be made, will necessarily depend on the conditions in that country as well as those abroad, and these questions can only be determined by the proper authorities in each country separately. In the following section we set forth a series of suggestions of a general nature which would seem calculated to facilitate the work of the Conference on the monetary side.

(1) Conditions under which a restoration of a free international gold standard would be possible.

(a) The solution of major outstanding political problems would contribute to that restoration of confidence without which great hesitation will be felt in taking decisions to return to the gold standard.

(b) In the second place, a series of measures would have to be taken in order to make it possible for countries whose reserves are at present inadequate to attain a satisfactory reserve position :

- (i) A settlement of inter-Governmental debts would be of particular value in this respect;
- (ii) A return to a reasonable degree of freedom in the movement of goods and services;
- (iii) A return to freedom in the foreign exchange markets and in the movement of capital.

(c) There should be a general understanding about measures to ensure a better working of the gold standard in the future. Success in obtaining an understanding of this character will not only be a factor of potent influence on public opinion in many countries, but will also give the assurance to an individual country that, as long as it pursues a sound monetary and economic policy, it will be in a position to acquire and maintain the necessary reserves."

International action, however, must be supported by internal equilibrium in the following matters :—

- (1) " Revenue and expenditure, not only of the State Budget proper, but also of the budgets of public enterprises (railways, etc.) and of local authorities, should be balanced.
- (2) It will be necessary to create and maintain healthy conditions in the internal money and capital market, and at all costs to avoid an inflationary increase in the note circulation in order to meet Government deficits.
- (3) It is necessary to give that sufficient degree of flexibility to the national economy without which an international monetary standard, however improved, cannot function properly.

We feel that, in practice, certain countries are in a key position, in that the re-establishment of a free gold standard by them would influence action in a number of

other countries. We are well aware of the difficulty, for countries no longer on the gold standard, of returning to that standard at an appropriate rate of exchange, so long as uncertainty prevails with regard to the course of gold prices. The experience of the last decade has shown that the restoration of the gold standard at too low a rate of exchange, as well as at too high a rate, presents grave disadvantages, not only from the national, but also from the international point of view. On the other hand, the very fact that exchanges continue to fluctuate is not without its effect on the level of gold prices and may hamper a monetary and economic policy designed to promote a recovery of prices in gold countries. In the face of this dilemma it would appear necessary to consider what policy may best be pursued in the immediate future in order to bring about such a general recovery as would facilitate the re-establishment of the international monetary standard."

It is to be hoped that the last line but one, in which I have italicized one word, does not represent a begging of the question whether after all the gold standard represents an unequivocally suitable international monetary system. Discussion on that point, together with the related problem as to whether the experts' idealist overhauling of the standard in their subsequent suggestions is a feasible project, has generally been understood to have been reserved for the full Conference in London. The committee of experts recognised in a later paragraph that a final decision did not lie within its power. Accordingly, it recommended that a certain set of conditions should be secured as a form of interim approach to any final monetary settlement. Liberal credit policies were highly desirable in the remaining free gold countries, whilst gold movements and

capital transfers outward from them ought to remain unhampered. In those countries already off the gold standard any form of competitive depreciation or devaluation of the currency was to be avoided, and speculative interests manipulating the exchanges up and down ought to be curbed by a preventive "smoothing" policy on the part of the authorities regulating the currencies concerned. Exchange restrictions were to be relaxed as soon as possible. Then, as a further confirmation of the independent position still left to Governments and central banks, the experts continued :—

" It is important that any declarations in favour of the restoration of an international gold standard should, at the same time, indicate certain essential principles for its proper functioning under modern conditions. . . . We would suggest that the Conference emphasise the importance of the monetary organisation being so arranged as to make Central Banks independent of political influence. We also feel it important to suggest that Governments in their economic and financial policy should avoid increasing the difficulties of Central Banks in the discharge of their responsibility."

Their final clauses on monetary and credit policy deal mainly with a number of economies in the use of gold which have been touched on by other gatherings of experts in their reports in recent years. The grand tussle over the practicability of introducing them all has still to come. For the moment, therefore, the United Kingdom can rest assured that it is lending a full share of assistance to the elucidation of the true gold position without having committed itself in the matter of the

monetary standard finally to be adopted by this country.

In the face of the Government's refusal to allow the currency to be linked to gold, it would be unjust to describe the existing system as an unblemished form of managed currency. There can be many kinds of management, and the present form will not necessarily offer the most desirable in the long run. It may almost be described as a politically managed currency. The Government will decide when reorganisation will take place: Parliament's vote will fix the points at which stabilisation of (presumably) prices and exchange rates is to be effected. The Government accepted the Opposition's amendment¹ to the 1932 Finance Act putting the Exchange Equalisation Account of £175 millions specifically under the control of the Treasury, and not of the Bank of England, though it has been intimated that the Treasury always listens to the Bank's advice "with the greatest respect." The Government, accordingly, finds itself in a position effectively to dominate the London foreign exchange market if it wishes to do so. Meanwhile, since note redemption in gold bullion has been suspended, this country's price level is divorced to a great extent from commodity price movements in "on gold" countries. As a result, sterling price levels, and for the main part the level of sterling exchange quotations, are governed by the credit policies of the Bank of England and the commercial banks, which in their turn hinge largely, through the

¹ Moved by Sir Stafford Cripps on April 25th, 1932.

" Bankers' Deposits " item of the Banking Department, on the note-issuing powers of the Issue Department. Gold purchases by the Bank in recent months have indeed led to some expansion in the country's credit base, but since the suspension of gold redemption the vital factor has been the size of the fiduciary issue. The 1928 Currency and Bank Notes Act invested the Bank of England with the duty of taking the initiative in the matter of an alteration in the size of the fiduciary circulation, though ultimate oversight lies within the power of Parliament. Permission to maintain the fiduciary issue above the 1928 statutory limits may be granted by the Treasury, upon the Bank's application, for maximum periods of six months only, while at the end of two years of such expansion Parliament has to review and agree to any further extension of the increased issue. This final control through the House of Commons means that Parliament, or in effect under present political conditions the Treasury, could impose its terms for allowing a continuation of the Bank's right to take the initiative if renewals were applied for beyond the allowed term of two years. It could, if it were so willed, fix an upward limit to the expansion, or insist upon a further increase in the emission of fiduciary notes. This is not to say that the Government's actions in this matter will probably partake of the character of the worst type of political manipulation of the note issue, as seen in several continental countries since the end of the Great War. A number of foreigners have already taken heavy losses and been unex-

pectedly surprised because of their lack of faith in the power of the British Treasury and monetary authorities to respect the teaching of prudent banking experience. But nevertheless this element of political control in the regulation of note issues is not one which the leading experts on central banking technique favour as a long-term policy. Political majorities come and go, and at some future date the dominant party may be disinclined to accept an increase of £15 millions in the fiduciary note circulation as in any way an adequate figure. If the general outline of the system at present in force still prevailed at that future time, with note redemption suspended, or the present expansionary provisions had by then been grafted on to a mildly reformed type of gold standard, the inexperienced hands of politicians might eventually force an undesirable type of inflation in the note issue. The size of fiduciary note circulations cannot be tampered with so lightly.

An ultimate danger exists even though a strong Government acting on the soundest banking advice may be in power at the moment. Public opinion may well be content to leave currency control in its hands for the present, but London's predominant financial power would quickly be undermined if at some future date it became evident that British currency policy could not wholly be disentangled from the vagaries of party politics. When these weaknesses come to be more widely realised, and round about the time when the economic horizon has cleared, opinion will once more be

directed to a monetary standard which may be felt to contain an element of sound financial discipline, just as before the return to gold by this country in 1925 the elemental order of that system was largely counted upon, once it had been restored, to introduce a revivifying stability to international trade.

CHAPTER IV

TYPES OF POSSIBLE MONETARY SYSTEMS

THE system desired can best be characterised as one of pliant soundness. A variety of choices has never been lacking, least of all in the dim obscurities of 1932. Silver has been thrust forward in recent months by old and new-found friends. As a single standard it would never again find universal acceptance, but a number of interests profess to see in a bimetallic standard of gold and silver the restoration of world price levels, and in particular of profitable trade with the teeming millions of the Far East. Bimetallic controversies distinguished several decades of the nineteenth century in Great Britain, and its advocates never succeeded in impressing the foremost economic opinion with the soundness of their case. The recent revival of the agitation has unearthed no fresh argument of any acceptable weight, and the adoption of the system seems extremely unlikely. Silver's case stands in need of substantial repair after Professor T. E. Gregory's study of the position.¹ As he indicates, the interest of silver producers (particularly in the United States) in the rehabilitation of that metal can well be understood,

¹ "The Silver Situation," by T. E. Gregory. Manchester University Press, 1932.

as can the urgent advocacy of their political representatives. When protestations are made against the "disastrous" decline in silver prices, some statistical doubt exists as to whether there has been an excessive relative fall in silver quotations in the period since 1914 compared with the decline in the world gold-level of wholesale commodity prices.

Some currency investigators have probed the possibility of introducing symmetrical standards, or note issues against an amalgam of gold and silver in given proportions. This proposal contains a measure of mathematical and assaying ferocity, apart from most of the objections which can be brought up against what is fundamentally an extended version of bimetallism, which is unlikely to commend it to governments or currency authorities. Neither does the mathematical complexity of a "compensated sovereign" on similar lines to the compensated dollar suggested by Professor Irving Fisher for the United States add to its attractions for this country. Its rejection appears most probable, as does that of an inconvertible paper currency under independent management. The latter, however, will not lack a strong school of supporters when the final scheme must be decided upon, but viewing the course of world monetary history up to the present time it scarcely seems probable that British, let alone world, financial opinion has yet been prepared for the warm-hearted acceptance of a monetary standard of this nature. Britain, in view of her international monetary relations, can never completely ignore the predilections of foreign coun-

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tries whose short-term money may find employment in London or whose trade may be financed to a considerable extent by sterling bills. It will prove difficult to discard some form of contact with a metallic background to the currency. The history of inconvertible note issues, despite recent British and Swedish experience, has up to date been characterised more by mismanagement than by prudent management, and not many economists as yet have sufficient faith in man to eliminate all human fallibility which may enter into the use of this type of standard.

It follows, then, that the bulk of expert opinion will not countenance too radical a departure from some form of link with gold. The pre-War code modified into a bullion standard cannot be reintroduced with its crude form of automatism. Its 1925-31 version provided such unhappy consequences that it is difficult to follow those who urge that Britain must return to a gold standard which is almost an exact imitation in its essential features of the pre-September 1931 model. Such an attitude grants meagre esteem to the growing economic intelligence of man, and is tantamount to a denial that the social wisdom of mankind could achieve results as equitable as those returned by the irregularity of mining for a dead metal. Protagonists of such opinions also claim that their call for the maximum of approximation to the old ways springs from the fundamental necessity of showing the nicest regard for our position as merely one of a trinity of monetary powers, the others

being France and the United States. They tend to overrule the difficulties of Britain's reaching a satisfactory agreement with these two countries as to the nature and working of this "new" gold standard, while at the same time they minimize Britain's ability to assume the leadership among this trinity and to strike out for a more rationalized type of standard which the others may adapt and adopt should they deem it to their advantage. In essence the basis of the fears moving minds along these paths would seem to be a chronic attack of the inflation bogey, to which they fear a simple-minded Britain would fall an easy victim under any other type of standard whatsoever.

The difficulties and dangers attendant upon renovating the gold standard along the lines sketched by the League Delegation, or by Mant, Strakosch, and Janssen, have already been dealt with in Chapter II. Little need be added to that analysis beyond stating that radical all-round reductions of reserve ratios and of the gold content of standard coins would contribute materially to a prolongation of the gold standard's life in its Gallic or trans-Atlantic sense. The practicability of obtaining them, however, is debatable. Even a stringent reduction in reserve ratios alone would assist in extending for some time to come the workability of this type of standard. A lack of statistical study, however, as indicated previously, at present hinders any conclusive judgment on the value and durability of this "repair." If the coming World Economic Conference should lead eventually to a cutting down

of the requirements for gold currency reserves on these lines, it would indeed register a most helpful achievement.

Some attention has been given to a flexible currency system of the Federal Reserve type as a suitable model for imitation over here. Federal Reserve notes, according to the Act before its amendment in February, 1932, by the Glass-Steagall Bill, had to be covered by a minimum gold holding to the extent of 40 per cent., the remaining 60 per cent. being secured by eligible short-term securities as defined by the Act. These eligible securities could be divided broadly into the following classes :—

1. Notes, drafts or bills of exchange arising out of actual commercial transactions, whether in industry, agriculture or commerce. Such paper must bear the indorsement of a member bank or a federal intermediate credit bank, whilst the maximum tenour allowed is ninety days, excluding days of grace. No paper which is intended to cover trading in stocks, bonds or other investment securities will be allowed, but notes, drafts or bills of exchange indorsed by a member bank, and issued or drawn to cover dealings in bonds and notes of the United States Government may be rediscounted by Federal Reserve banks, and under the authority of sections 16 and 13 of the Federal Reserve Act used as cover against the Federal Reserve note issue. Limits are prescribed for the amount of paper which will be taken by a reserve bank

from one member bank in connection with any one borrower's name, except in the case of "the discount of bills of exchange drawn in good faith against actually existing values."

2. Acceptances of member banks covering exports or imports, or the domestic shipment of goods, and having not more than six months to run.

3. Acceptances of member banks which are drawn by bankers abroad for the purpose of furnishing dollar exchange, with a maximum tenour of three months' sight, exclusive of days of grace.

4. Notes, drafts and bills of exchange indorsed by a member bank, and issued or drawn for an agricultural purpose, or based upon livestock; with a maturity not exceeding from six to nine months, and, if the tenour runs for more than six months, secured by warehouse receipts or other negotiable documents giving title to readily marketable staple agricultural products, or by chattel mortgage on livestock which is being fattened for market.

5. Agricultural securities of the type outlined in (4) above which are brought to Federal Reserve banks for rediscount by Federal Intermediate Credit Banks.

6. Purchases in the open market by Federal Reserve banks of (a) bills of exchange eligible for rediscount, as described in section (1) above, (b) bankers' acceptances having not more than

six months to run and covering exports or imports or the domestic shipment of goods.

7. Promissory notes of member banks secured by eligible paper of the types described above, or by the deposit or pledge of bonds or notes of the United States. These promissory notes cannot run for a longer period than fifteen days. Nevertheless, there is nothing in the Act to prevent their renewal again and again. Insofar as Government securities are utilised to back the promissory notes it must be granted that here exist potentialities for an expansion of Federal Reserve note issues (assuming that gold reserves are already held in sufficient legally-required quantities) against paper which may not strictly be linked with a trading transaction. It should be noted that the Government securities *have to secure the member banks' promissory notes*. A straightforward purchase of Government securities by themselves on the part of the Federal Reserve banks did not suffice to endow them with the status of Federal Reserve note cover.

In the majority of cases the Federal Reserve Act indicates methods for computing the maximum amount of a particular type of paper which a Federal Reserve bank will rediscount for any one institution. Further, the Federal Reserve Board has utilised its powers to draw up regulations governing the same matter. The aim of the framers of the system has thus been to base the elastic element in the total

note issue mainly upon the varying volume of short-term securities which arise primarily out of trade transactions. These are deemed to be essentially of a self-liquidating nature. Such a standard is undoubtedly more resilient than a 100 per cent. gold backing requirement, or a quasi-rigid volume of fiduciary notes beyond which a 100 per cent. gold cover is called for. But disadvantages can be discovered when one examines at close quarters the conditions under which this "eligible paper" expansion idea must be worked. Much of the eligible paper needed is of the bill of exchange variety, and despite the vigorous campaign of the late Mr. Paul Warburg and the American Acceptance Council, it is doubtful whether this type of financing has caught on in the United States to the extent that the authorities desired in order to smooth the working of the note issue system. Should the volume of commercial bills and analagous paper fail to develop *pari passu* with the expansion of general trade, or should their volume contract too rapidly in periods of trade decline and falling prices, and so by their scarcity render more difficult wishes and attempts to "reflate" and revive industry, the insecurity of the system cannot be discreetly ignored.

In a period of active trade development the business community may show a tendency to finance the expanding volume of orders by bank advances rather than by paper of the type eligible for rediscount and use as cover against notes. This difficulty may be circumvented when gold holdings by the Reserve Banks are so plentiful that reserves well in

excess of the 40 per cent. legal minimum may be held against Federal Reserve notes in the form of gold. This increase of the gold cover would naturally diminish the need for eligible paper to make up the 100 per cent., and any inadequate supply of the latter would thereby be partially concealed. A more menacing danger arises, however, at a time when trade contraction overhangs the country's business. Prices of both agricultural and manufactured products may have fallen to extremely low levels as the result of world market conditions. Farmers, for instance, may have few unattached assets against which eligible paper may be issued, and certainly a considerably diminished gross value of their crops and livestock upon which to base "eligible" paper. Manufacturers, too, will find their home market slowing up with disquieting deliberation as a result of the vast agricultural community's difficulties. In addition, a simultaneous drying up of foreign purchasing power will cut down their exports. This is scarcely the time when the machinery of the monetary system should pile limitation upon contraction in the national economic structure through an unavoidable clamping down of the note issue and credit facilities. Yet a period of widespread difficulties such as those described would be precisely one in which the volume of eligible paper arising directly out of goods transactions may decline almost precipitously. The member banks of the Reserve system may, in spite of all, still possess a supply of eligible assets with which to obtain rediscounts if they need them at the Federal

Reserve Banks. This was approximately the type of situation in which the United States found itself involved towards the end of 1931 and at the beginning of 1932. The member banks of the system had started in September, 1931, to borrow more heavily from their Federal Reserve Banks. The commercial banks had held a fair margin of reserves in excess of their legal requirements in September, but the surplus margin had been markedly reduced by the end of 1931, and this relatively strained reserve position of member banks persisted into the early months of the following year. They were accordingly compelled to increase their borrowings from the Federal Reserve, though such amounts as they took made but slight inroads into their total holdings of "eligible assets." General nervousness was spreading, and as the toll of bank suspensions increased, the member banks tended to cling more grimly to their eligible assets. Little call came for an expansion of loans to an apprehensive business community against sound commercial security. Not knowing when more serious affliction might strike them, the commercial bankers held on to their eligible assets in the hope that should the worst befall they would still possess something against which the Federal Reserve institutions were bound to grant them credit. Thus the Reserve Banks found the eligible paper which they required to hold behind Federal Reserve notes withheld from them by their own member banks. If the Federal Reserve institutions desired to expand credit and note issues as a means of inducing a rise in commodity prices

from the disastrously low level to which they had fallen, they were confronted with this unexpected difficulty in obtaining eligible paper from their own nervous member banks.

At the same time, a foreign drain on the country's gold reserves tended to pull down the metallic note backing closer to the minimum amount stipulated by law to make up the total cover of 100 per cent. This would, of course, demand merely 40 per cent. of gold if enough eligible paper were forthcoming to provide the other 60 per cent. But if only 50 per cent. could be covered by the available eligible paper, gold would have to supply the rest, and that, too, without allowing for the fashionable central bank policy of endeavouring to hold somewhat more than the minimum reserve in gold in order to utilise the excess as a cushion against still further extraordinary shocks.

In the midst of this concatenation of evil tendencies public uncertainty led to an increase in the note issue, chiefly for purposes of hoarding. With insufficient eligible paper coming forward to furnish its share of the cover against the notes, export pressure on the gold reserves, and growing calls for notes by hoarders, the basis for any hope of trade revival appeared to be slender. Using the Reserve Banks' returns for February 24, 1932, the Federal Reserve authorities calculated that there were only \$416 millions of "free," or surplus, gold available after allowing for the legal reserve requirements of a total gold and collateral ratio of 100 per cent. against Federal Reserve notes, as

(In Millions of United States dollars.)

End of Month.	Federal Reserve Notes.		Federal Reserve Note Cover.			Bankers' Dollar Acceptances Outstanding.†	Commercial Paper Outstanding.	Reporting Member Banks in leading cities—Borrowings at F. R. Banks.	All Member Banks.			Date of Member Banks' quarterly returns.
	Issued to F. R. Banks by F. R. Agents.	In actual circulation.*	Gold.†	Eligible Paper.	U. S. Govt. Securities.				Holdings of Government Securities and Eligible Paper (including all paper under rediscount).			
									U. S. Govt. Securities.	Eligible Paper.	Total.	
1931												
Feb. . .	1,870	1,478	1,709	265	—	1,520	315	57	4,707	3,198	7,905	June 30
June . .	2,102	1,724	1,918	231	—	1,368	292	56				
July . .	2,180	1,764	2,056	225	—	1,228	289	44	4,936	2,996	7,932	Sept. 29
Aug. . .	2,343	1,963	2,154	317	—	1,030	271	75				
Sept. . .	2,532	2,098	1,928	712	—	996	248	127	4,694	2,573	7,267	Dec. 31
Oct. . .	2,746	2,429	1,552	1,349	—	1,040	210	398				
Nov. . .	2,773	2,180	1,735	1,107	—	1,002	174	404	4,694	2,573	7,267	Dec. 31
Dec. . .	2,926	2,624	2,130	915	—	974	118	499				
1932												
Jan. . .	2,923	2,665	2,058	1,006	—	961	108	469	Returns not called for.			March 31
Feb. . .	2,912	2,651	2,069	892	—	919	103	434				
1933												
March . .	2,817	2,564	2,211	667	—	911	106	368	4,979	2,428	7,407	June 30
April . .	2,774	2,566	2,275	562	—	879	108	277				
May . .	2,795	2,572	2,100	485	295	787	111	185	5,626	2,424	8,050	Sept. 30
June . .	3,028	2,795	1,956	453	634	747	103	191				
July . .	3,080	2,859	1,969	525	611	705	100	212	5,763	2,246	8,009	Dec. 31
Aug. . .	3,052	2,814	2,082	417	578	681	108	164				
Sept. . .	2,984	2,750	2,189	315	499	683	110	128	4,979	2,428	7,407	June 30
Oct. . .	2,948	2,709	2,192	312	455	699	113	103				
Nov. . .	2,933	2,692	2,242	294	444	720	110	99	5,626	2,424	8,050	Sept. 30
Dec. . .	2,987	2,739	2,351	220	428	710	81	75				
1933												
Jan. . .	2,937	2,725	2,407	256	313	707	85	63	Returns not called for.			March 31
Feb. . .	3,679	3,417	2,225	856	—	—	—	95				

* Include notes held by Federal Reserve Banks and in U. S. Treasury.

† Includes gold, gold certificates and gold in Federal Reserve Board Gold Fund.

‡ American Acceptance Council figures.

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well as for the amount in the redemption fund held by the U.S. Treasury against Federal Reserve notes, and the legal reserves against deposits.

The nature of the position which arose can be seen by examining the table on page 83. The statistics dealing with bankers' dollar acceptances and commercial paper outstanding reflect the general trend of the volume of business paper which was counted upon to back the note issue. It should be remembered that these figures do not contain all the types of eligible paper. The figures relating to total eligible assets, it can be seen, are divided by the *Federal Reserve Bulletin* into "United States Government Securities" and "Eligible Paper," the latter of which would mainly comprise trade paper. An additional difficulty around the end of 1931 arose through the unbalanced holding of eligible paper by member banks. The larger city institutions had in a number of cases substantial portfolios of these quick assets, whereas banks in smaller townships and agricultural areas, which stood in relatively greater need, found their amount of eligible assets far from comfortable. Nevertheless, when discussing these problems towards the end of February, 1932, Senator Carter Glass indicated that Federal Reserve member banks possessed eligible assets amounting to \$8,561,648,000, out of which they had rediscounted only \$465,711,000. Only ninety-one banks out of 7,600 in the Federal Reserve system had exhausted their eligible paper. The real problem, he insisted, was to induce members to utilise their eligible assets at the Reserve Banks.

Otherwise the Reserve system could not hope to help a price revival on its way. Eligible assets were not rediscounted because of member bank timidity. The course of trade, production and prices throughout the period under examination is well known for the widespread downward sweep, and the statistics reproduced typify the awkward contraction which appeared in a vital element of the Federal Reserve note-issue system.

Note-cover regulations were actually tending to act as a hindrance to trade revival in the United States. The Federal Reserve Banks had still to be prepared to stand up to a drain of gold abroad, should that arise from a lack of confidence, whilst at home the possibility of expansion in note issues, either because of hoarding, or because of a trade revival which the Government was endeavouring so zealously to foster, had still to be borne in mind. Congress therefore broadened the basis of the Federal Reserve note issue by passing the Glass-Steagall Bank Credit Bill, which received the President's assent on February 27th, 1932. It will be observed that to mark the taking of this remedial step a double line has been drawn between the figures for February and March 1932 in the table on page 83. Senator Glass revealed during the debate that he himself was impressed not so much with the need for broadening the rediscount base for eligible paper as with the necessity of inducing member banks to bring their eligible paper more freely to the Reserve Banks. The commercial banks had been frightened to death, fearing that

once they parted with their existing eligible paper they would have no prime reserves left. The new Act removed this worry, since Government securities could now stand behind eligible paper originating according to the requirements of the Federal Reserve Act. It was intended that member banks should still be called upon to utilise all their acceptable commercial assets before being allowed to receive Federal Reserve notes against a sale of Government Securities. The new legislation merely gave them a secondary line of defence. In his statement explaining the aims of the Bill, President Hoover admitted quite openly that it would free vast amounts of gold in the Federal Reserve System in excess of the gold reserve required by law, and "so enable them beyond question to meet any conceivable demand that might be made on them at home or abroad." Further, he averred that it was expected to strengthen the whole credit structure, and so open the channels of credit as "to permit the Banks *more adequately to serve the needs of agriculture, industry and commerce*" (my italics), a phrase which stood equivalent to an admission that the existing note-issue system had really failed when under stress. The introducers of the measure had calculated that its passage into law would at once increase the Federal Reserve system's free gold by nearly \$1,000 millions. The efficiency and success of the note-issuing machinery had hitherto been assumed too readily in the post-War period, whereas the United States' vast holdings of gold had almost continuously rendered the

condition of an apparent success easy to discern. A loosening of the joints had now become imperative.

The Act amended Section 16 of the Federal Reserve Act and allowed "direct obligations of the United States" (*i.e.* Government securities) to be held against Federal Reserve notes, providing that the Federal Reserve Board, by a majority vote, deem it in the public interest. Reserve Banks could acquire these by open purchase. Permission to do so, however, was shrouded with the utmost caution. In no event could such security be less than the amount of the Federal Reserve notes applied for, whilst the clause was to remain in operation only until March 3rd, 1933, after which date (or sooner, should the Federal Reserve Board so decide) "such authorisation shall terminate and such obligations of the United States be retired as security for Federal Reserve notes." It almost appears as if on the verge of a notable advance in note issue regulation the American authorities sprang back hurriedly, anchored themselves to March 3rd, 1933, and then returned to explore the verge once more. Critics within the United States did not hesitate to deplore the "violation of sound banking principles" which the Glass-Steagall Act had brought about, and in outbursts of enraged scepticism reminded the country that even during the War period all the Liberty Loan issues were expressly debarred from use as note cover. A severely orthodox school denounced what it believed would be a prompt emission of notes to the full minimum limit of a 40 per cent. gold reserve,

or, in other words, the danger point fixed in the law. The legalistic channels of thought still endured.

If the American authorities cherished a hope that all would be well with the eligible paper supply by the time the Act expired, they should have pointed out to them the unwisdom of allowing hope and chance to enter so largely into a leading trading country's monetary system. It would not appear that they had as yet contemplated the idea of placing that part of the circulation not covered by gold (but backed by securities) under the supervision, and subject to the alteration, of a committee of men completely independent of Congress and specially qualified for the task.

The Hoover régime came to an end on March 3rd, 1933, it is true, but before that date arrived legislative provision had to be made for the renewal of the Glass-Steagall law for another year. A validity of two years had been the original intention of those who drafted this clause of the Act in 1932, but its term had been whittled down to one year during Congressional examination of the Bill in February 1932. An interesting situation will arise early in 1934, when the continuation or refashioning of this Act has to be undertaken by the new Democratic Government. A survey of the note-issue statistics in the table shows that United States Government securities were first utilised as note cover under the terms of the Act in May, 1932, and that from June onwards their volume in each month up to February, 1933, exceeded the amount of "eligible paper" held against Federal Reserve notes. The

gold holdings fell away until June, but picked up steadily in the second half of the year, whilst the total Federal Reserve note issue ranged during 1932 at higher levels than at any period of 1931. United States gold stocks received some large increments around the end of 1932 and in January, 1933, and it will be instructive to observe whether this denudation of other countries' gold stocks—apart from the possibility of any subsequent drain of gold away from the United States—will ease the note cover position in the country to such an extent that by March 4th, 1934, the American monetary authorities can dispense with the Glass-Steagall support. Judging by the latest statistics available, it appears extremely doubtful whether this will be possible. Some prolongation of the life of this "emergency" measure, which resembles so little the ideals of those who passed the Federal Reserve Act, would seem to be demanded by the exigencies of the times. As it stands at present the Glass-Steagall Act represents a political intrusion into the realm of currency issue, and as such the position is not without risk unless the most discriminating control is exercised.

Nevertheless, one cannot guarantee that short-term commercial securities will be relatively more plentiful by March 3rd, 1934. It is possible that, failing the success of some large-scale funding operations, Government short-term paper may make heavier demands on the short-term money market during the next few years than paper arising out of genuine business transactions, since United

States budget deficits have recently been on such a stupendous scale.

When the likelihood of setting up a system of this type in Great Britain comes to be examined, the artificial nature of American experience up to the end of 1930, and the dangers and "chanciness" of the system which have since become apparent, cannot be ignored. A revival of the bank acceptance in internal trade in this country would no doubt be demanded, and though leading bankers have thrown out this suggestion on several occasions since the era of low money rates descended upon London, it is doubtful whether any generous response has been possible in existing trade conditions. In any case, bank advances would probably prove to be too firmly established as the more usual type of trade financing. Note-issue cover would constitute a heavy drain on such commercial paper as was available in future, for the greater part of the material available in the London bill market since the War has been Treasury paper. In short, therefore, whatever British monetary system may be decided upon ought to enable ample allowance to be made for the demand for bank advances when regulating the notes to be issued beyond the value of any gold cover.

Addendum (April 22nd, 1933).

MARCH AND APRIL, 1933

The strain on the banking and in particular the note-issue systems of the United States, leading up

to the moratorium of March 6-9, 1933, must be regarded as a stress of episodic abnormality when viewing critically the main note-issue system of that country. The rush to withdraw bank deposits in the form of notes or gold—in short, a rush to hoard—sprang essentially from a passing wave of intense public suspicion regarding the solvency of banking institutions. Understanding of the difficulties of the time, and not criticism, must therefore characterise the foreign observer's opinions on the liberalizing of the conditions governing security against fiduciary currency which took place, in order to appease bank depositors' possible demands. An Act passed on March 9th of this year amended Section 18 of the Federal Reserve Act and allowed circulating notes, or in other words Federal Reserve Bank notes, to be issued by Federal Reserve Banks upon their depositing with the Treasurer of the United States either :

- (a) Any direct obligations of the United States, the amount of notes issued against these to be equal to the full face value of the securities concerned ; or
- (b) Any notes, drafts, bills of exchange or bankers' acceptances acquired under the Reserve Act, the amount of notes issued not to exceed more than 90 per cent. of the estimated value of the securities so deposited.

Official statistics for the succeeding month reveal that far less resort to the emission of the new Federal Reserve Bank notes had to be taken than

might have been expected. Panic had receded. In this case, too, the enabling Act again insisted on the transitory nature of such fiduciary currency, since once the President declared that the emergency recognized in his proclamation of March 6th, 1933, had terminated, Federal Reserve Bank notes could continue to be issued only against United States' bonds bearing the circulation privilege prior to the emergency legislation.

Crisis will pass, but intriguing problems in connection with the ultimate control and regulation of the fiduciary portion of the note-issue will linger behind to be settled. The official suspension of the gold standard by the United States on April 19th, and the accompanying consideration of proposals to liberalize still further the conditions of note-issue, merely accentuate the interesting nature of the brew now being stirred and mingled with the formerly hallowed principles of note emission. Approval cannot possibly be withheld from attempts to restore the general run of prices to more tolerable levels. And proposals to reduce the gold content of standard coins must be hailed as laudable endeavours to refurbish a gold monetary standard whose valid working life can be extended in some measure beyond the short period threatening mankind at the moment. But will its life thereby be prolonged for any adequate period? And should all our hitherto-accepted criteria regarding the control and issue of the fiduciary part of note-issues be completely renovated?

CHAPTER V

A NEW METHOD OF MONETARY REGULATION

IN view of the objections which can be brought up against the institution of standards of the types already touched upon, it is possible that the machinery of a new "gold system" may be constructed for the enduring benefit of the trade of Britain and those countries which may decide to fall in with the scheme. The plan outlined below would appear to offer the basis of this new and more harmonious system. Criticism of certain details will probably enable the framework to be built more securely, but the first outline of the plan may furnish a fresh peg to which the discussion of a currency standard can attach itself.

When the generally accepted desiderata for the stabilisation of sterling have been achieved, Parliament may be expected to proceed to legislate on the new gold content of the sovereign. Such authorities as it chooses to consult may have agreed that the international political and debt situations warrant the step, and that equity would not be offended if approximately the prevailing level of wholesale and retail prices, wages and foreign exchange rates were linked more formally. In a word, that longed-for state of political and economic equilibrium is deemed

to be at hand. The sovereign will be defined as so many grains of gold eleven-twelfths fine, and a standard price fixed for gold, with the Bank of England prepared at any time to issue notes at this rate against gold brought to it. The volume of the fiduciary issue of Bank of England notes is to be under the sole control of a Currency Board, whose membership will be detached from Parliament and separate from the Board of Directors of the Bank of England, though, since the Bank is charged with the business of issue and redemption, a close link must be maintained between the Currency Board and the Board of the Bank.

Assertions have been made on many occasions in Parliament, both in the 'forties of last century and since the Armistice of 1918, that the issue function is, in a way, a matter of special interest to the nation as a whole which has been assigned freely by the State to the Bank of England. Special protective regulations have been imposed with the intention of enabling the Bank to carry out the task unhampered and in a disinterested spirit of national duty. Political intrusion has occurred only at times of national stress. The Government pointed out in the House of Commons last year, in the debates on the Exchange Equalisation Account, that this was the case. The profits of the fiduciary issue, whether it be £260 millions or £275 millions, are paid over to the Treasury by the Bank after the expenses of the Issue Department have been met. It does not appear, therefore, that the formation of a Currency Board of experts, who are expected to reach their

decisions through their broad-visions judgment on national and Commonwealth requirements, would constitute an unwarranted meddling with the Bank of England's territory. Objection or resentment on the part of the Bank authorities could not possibly be sustained, even if it were likely that the present Board were prepared to oppose the measure.

The existence of a Currency Board would to a certain extent reduce the responsibilities of the present Board of the Bank, and it may be questioned whether the existing Board is not competent to control the size of the fiduciary circulation. The method of selection for the Board, however, can scarcely be described as having a broad national basis, eminent though many of the men have been whom duty has called to its councils. Other minds equally, if not more authoritative in currency matters may rise to national eminence by routes differing widely from those normally taken by the Bank of England director. Further, various types of the selected expert "Board" idea are not exactly discredited in Great Britain, where the Central Electricity Board, the Port of London Authority and, most recent of all, the London Passenger Traffic Board and the Import Duties Advisory Committee, have already been heard of, whilst the iron and steel industry has been induced to set up a broad national committee charged with the delicate task of superintending a reconstruction within the industry. Looking abroad, currency boards function in such countries as the Irish Free State, Palestine, a number of Crown Colonies and in Iraq, though it is true that their

duties are mainly to peg their local currency against one under overseas control. The successful outcome of the principal tariff agreements signed at Ottawa is dependent upon the efficient functioning of impartial tariff boards set up in the countries concerned. It may even be urged that the Federal Reserve Board is appointed on a national basis, though criticism within the United States has sometimes been heard against the choice of representatives appointed under an extremely democratic election system. It follows, then, that a Currency Board in Britain ought not to be regarded as an outrageously revolutionary step. Since it will have to meet and consider periodically the permitted amount of the fiduciary issue, the constitution of its membership forms a highly important matter, and it would be well to survey thoroughly the basis on which it ought to be appointed.

Membership of the Currency Board

The Board should be chosen in two sections, (a) United Kingdom members, (b) Overseas Commonwealth members, though both would always participate in joint sittings and reach joint agreements by majority vote. The United Kingdom members would consist of :—

1. The Governor of the Bank of England, *ex officio*, who will be debarred from holding the office of Chairman of the Currency Board. As an ordinary member he will be able to take a more active part in

its deliberations than he would if occupying the position of Chairman. The other members will look to him to be acquainted with the Treasury's viewpoint, though that will not necessarily be the one to prevail. In addition to the Governor, the Deputy-Governor of the Bank of England may attend all meetings of the Board, but will not rank as a member of the Board unless he is acting as deputy for the Governor in the latter's absence. With the Governor present, the Deputy-Governor may not count as a voting member. He may, however, consult with the Governor and take part in discussion provided the Chairman gives his permission. Should the Governor not be present, the Deputy-Governor will assume the full powers and privileges of a member of the Currency Board.

2. The Principal of the Bank of England's Statistical Department. This official would attend more in an advisory capacity, and would hold no voting power, since his opinions would obviously be subject to the influence of the Governor of the Bank.

3. One member, nominated by the Council of the Royal Economic Society, who is in no way connected with the Bank of England.

4. One member nominated by the Council of the Royal Statistical Society, who is neither a director, official nor shareholder in the Bank of England.

5. One member of British birth nominated by the Director of the London School of Economics and Political Science, who shall take the British members of the School's Professorial Council into consultation

and receive their concurrence by majority voting in the final choice.

6. One member of British birth nominated by the Senior Professor of the Faculty of Economics in Cambridge University, after consulting the Faculty on similar lines to those prescribed in the case of the election of member number 5.

7. A representative elected by the Clearing House Committee of the British Bankers' Association.

8. One member of British birth nominated by the Council of the Institute of Bankers, London. He shall not be a director of the Bank of England, but preferably one connected with a leading joint stock bank or a prominent overseas banking house.

9 and 10. Two bank members of the London foreign exchange market, of British birth, with wide practical experience, and who still retain contact with the market. Each of these members will have half a vote only at the Currency Board's meetings. They must be under fifty years of age at the date of selection and will not be eligible for re-appointment, except in the case of one of the first two choices. Members of this category will normally be appointed for a full term of six years, but one of the first two market members shall be appointed in the first instance for three years, and shall retain the right to re-appointment for six years, and no more, at the end of that period. These members are to be selected by a committee of the managing directors (one for each bank) or the London managers (one for each bank), or their fully accredited representatives, of the following banking institutions :—

Barclays Bank.	*District Bank.
Lloyds Bank.	*Royal Bank of Scotland.
Martins Bank.	*Bank of Montreal.
Midland Bank.	*Commonwealth Bank of Australia.
National Provincial Bank.	*Hongkong and Shanghai Banking Corporation.
Westminster Bank.	*Imperial Bank of India.

* The Chairman of this Electing Committee must be chosen from one of the banks marked with an asterisk.

The large number of men and institutions concerned in the selection of the two "market members" justifies a detailed definition of the procedure to be followed and the terms of service to which they will have to agree. Not more than one foreign exchange expert can be nominated by, or elected from, any one banking firm. In the event of more than five names being put up for the elections, a first ballot will have to be taken, and the five gentlemen at the head of the poll will then have their names put forward for a second ballot, as a result of which the leading two shall be declared elected. Should three names tie even then in the voting, those three alone should be submitted at a third ballot. If there still remains a triple tie after this, lots shall be drawn for two out of the three candidates.

It will be a condition of the appointment of the two market members that they shall each continue in their bank's service, but will be accorded by their employers privileges pertaining to persons engaged on a duty of national importance, with complete freedom to attend any meetings which may be summoned in connection with the Currency Board's work. They will receive a yearly payment of £1,000 during their membership, in addition to their usual salary,

which their own bank will continue to pay them, whilst when retiring upon the completion of their six years' appointment to the Board they are to receive a retiring grant of £1,000. An elected member may be compelled to retire before his term of office has expired, and in this case he should receive a retiring gratuity of £150 for each completed year's service, subject to an affirmative vote by the remainder of the Currency Board. The remainder of his period shall be served by the candidate who received the next highest number of votes at the time of the retiring member's election, should that candidate still be willing to undertake the duties. The fact that he has passed the age of fifty since the last election shall not prevent his eligibility to assume the post. Upon completing the original appointee's term of office, his successor shall not be eligible for re-election unless he has had a spell of actual service shorter than two years.

Whenever a fresh election has to be held to choose a new market member, the fact that a candidate may be on the staff of the same bank as the retiring member ought not to be allowed to weigh against his selection. Since the background of the election is the national interest, this must predominate, and ability alone should count. It may be urged that possibilities exist that a market member's bank may profit by his advance knowledge of the Board's decisions. The necessity of demanding some security for good faith from the employing bank and the market member has to be considered. To demand a temporary pledge of securities, however,

would put an unfairly low assessment on the capacity of British bankers to maintain an honourable secrecy. The Currency Board ought to be given a free hand in regulating this matter. Any failing on the part of a bank would entail so much stigma, besides a suspension of voting and nominating privileges, that it is extremely unlikely that more than a written undertaking by bank and market member need be deemed adequate and prove fully effective. All decisions of the Board with regard to the size of the fiduciary issue should be posted up immediately on the bulletin board of the Bank of England.

Terms of Service of Ordinary Members (Numbers 1 to 8 inclusive)

Apart from the two market experts, the remaining "ordinary" United Kingdom members on the Board, with the exception of Bank of England officers, shall be appointed for periods of five years, and shall be eligible for re-appointment for two further spells of a similar length up to a maximum period of service of fifteen years. With the exception of the Chairman, they shall receive an annual payment of £2,000 for performing their Board duties, and a retiring grant of £1,000 at the end of each period of five years' service. The two Bank of England members would hold their positions on the Currency Board as long as they occupied their posts in the Bank, whilst they would draw the same fees as the other members.

OVERSEAS COMMONWEALTH MEMBERS OF THE
CURRENCY BOARD

Since the purpose of the new method of administration of the monetary standard aims not only at as great a measure of price, wage and exchange equilibrium and stability as can be secured within the United Kingdom alone, but also within the whole of the British Commonwealth of Nations, it is indisputable that representatives of the overseas Commonwealth countries must be called upon to assist in carrying out the duties of the Currency Board. Furthermore, bearing in mind the nature of the 1926 declaration¹ defining the constitutional relationship of the different parts of the Empire to one another, as well as the footing upon which discussions took place at the Ottawa Economic Conference in 1932, the mass of overseas representation must not be swamped by United Kingdom voting power. If this were the case, it would scarcely be possible to induce overseas Commonwealth countries to enter into the scheme, and so extend the area of benefit to the maximum possible number of participants.

The scheme provides for co-operation on the part of Commonwealth countries, but these will not be bound to nominate their representatives to the Currency Board. Before they do this, however, some form of agreement between the country concerned and the countries already linked in the scheme

¹ Report of the Inter-Imperial Relations Committee, known as the Balfour Resolutions of the Imperial Conference of 1926. Cmd. 2768.

will have to be drawn up. This should stipulate that they will arrange for the management of their credit policy and note-issue arrangements in such a manner that their exchanges will approximate to an agreed par against sterling. The decision as to whether it shall give this undertaking, and whether the equilibrium of wages and commodity prices, and the adequacy of banking control within its borders justify the exchange rate which the country agrees to maintain, shall be an entirely free one on the part of the country concerned. Coercion on the part of Britain or the Bank of England would be out of the question. Commonwealth countries can stand aside from the plan if they wish to do so. Or, once in it, they may be entitled to withdraw upon giving eighteen months' notice.

If Canada is then afraid that the Board's policy, and her own adhesion to it, will run her dollar to a heavy discount against the American dollar, she will be at liberty to dissociate herself from the exchange stability which it will be the Board's principal aim to preserve, and to pursue a monetary course entirely of her own choosing. It may so happen, however, that any premium on American dollars in Canadian currency will arise from an appreciation in the value of gold owing to the United States' adherence to an unstable form of a gold standard. In these circumstances Canada may prefer not to break from the Indian file treading a firm path across the bog in order to chase a will-o'-the-wisp waving a Stars and Stripes in one hand and a bag full of Canadian bonds brought out in New York in the other. The extent

of Canadian commitments in American dollars introduces a factor to which the Dominion will have to give very serious consideration before entering into the Imperial stability agreement. It would be of material assistance to the world generally if the United States and her "associated" territories (her overseas possessions and, say, the Central American States and Mexico) were to arrive at an understanding to work a gold standard scheme on the British model. Some form of committee contact purely for discussion purposes might then be arranged between the two currency areas, or Canada herself might arrange for committee contact of this nature with the United States group. Even if the United States decided to make scarcely any change from the type of monetary system to which she held before March and April, 1933, no reason exists why some kind of informal survey of economic affairs should not take place periodically between her Treasury and Federal Reserve Board and the Currency Board domiciled in London. Canada's special position in relation to United States' dollar obligations will attach additional weight to her contributions to the meetings of the Currency Board. In view of this, and also of the fact that virtual control of Newfoundland's currency and credit arrangements is in the hands of Canadian banks, it would appear that Canada could justifiably be accorded two votes for her representative on the Board. This would also provide an apposite compliment to the status of Newfoundland and Canada as the two senior Dominions of the Commonwealth.

The full voting power of the Commonwealth members of the Currency Board could then be distributed on the following lines:—

Canada	2 votes	Irish Free State	1½ votes
Australia	1½ "	New Zealand	1 vote
South Africa	1½ "	India	1½ votes

A total voting strength of nine would thus outnumber the United Kingdom voting power (see pages 96–98) by one. For this reason the Chairmanship of the Currency Board should always be vested in one of the United Kingdom members numbered 3, 4, 5, 6, 7 or 8 on pages 97–98, the Chairman's annual payment for his services being fixed at £4,000. The Chairman will have a casting vote in the event of a tie in voting at the Board's meetings. Thus the complete composition of the Board and the voting power of its members can be summarised as follows:—

BRITISH CURRENCY BOARD

<i>Overseas Commonwealth Members.</i>		<i>United Kingdom Members.</i>	
One member from each of the countries designated below:			
Canada,	with 2 votes	Governor of the Bank of England with.	1 vote
Australia,	" 1½ "	Principal of the Bank of England's	
South Africa,	" 1½ "	Statistical Department, having	no vote
Irish Free State,	" 1½ "	*One nominated by the Council of the	
India,	" 1½ "	Royal Economic Society	1 vote
New Zealand,	" 1 vote	*One nominated by the Council of the	
		Royal Statistical Society	1 "
Total	9 votes	*One nominated by the London School	
		of Economics	1 "
		*One nominated by the Faculty of	
		Economics, Cambridge	1 "
		*One elected by the Clearing House	
		Committee	1 "
		*One nominated by the Council of the	
		Institute of Bankers, London	1 "
		Two foreign exchange market men,	
		between them	1 "
		Total	8 votes

The Chairman, who must be one of those gentlemen marked with an asterisk, shall have one additional vote, which may be exercised only as a casting vote in the event of a tie.

Each Commonwealth country will itself determine the method of selecting its representative on the Currency Board, and will incorporate the arrangements arrived at in the agreement drawn up and signed upon its entry into the currency scheme. The viewpoint that these elections shall not become the plaything of local politicians must, in fairness to other contracting countries, be fully accepted by each signatory Commonwealth State. The duties which have to be undertaken are in the highest sense of the word national. All parties within a country should as far as possible agree over adherence to the new system. Such a matter forms a subject on which the Hertzog Nationalist should feel that his standpoint is completely safeguarded in agreeing with the South African Party and the Labour Party. A Dominion's choice would remain unfettered. All that would need to be done would be to frame a plan for nominating its Board member which would give him the seal of full national approval, and which the other parties to the Commonwealth agreement accept as fair to them and their aims. It is suggested that a procedure which might possibly be adopted would be for the Government Treasurer (or Finance Minister), in consultation with the Governor of the country's central bank, or, if there be none, with a committee of the leading banks, to draw up a list of three likely names. These would be placed before

the Governor-General, who would nominate one to serve on the Board. For preference, such appointments should be made for an unalterable term of five years. The chosen representative would naturally have to reside in London for a fair portion of each year. He would be under an obligation to maintain contact with his country by frequent visits and consultations. All his expenses would be met by the appointing country, which would also make an annual payment of £4,000 (or its equivalent) to him for his services. These terms, however, are merely put forward to stir up the discussion, for each Commonwealth country would obviously decide such details in its own way.

The existence of overseas Commonwealth members of the Currency Board furnishes another strong argument in favour of taking the direction of the note issue away from the Bank of England Court and handing it over to the Currency Board. There must be these representatives concerned in the control of the note issue if the Commonwealth is to be linked up in the new currency system. It is hardly conceivable that the Bank of England would want them on its directorate, since they would there find themselves in a position to probe into all its business activities. They themselves would not wish to be concerned with items of the Bank's day-to-day affairs. They would be concerned primarily with but one aspect of business which is at present entrusted to the Bank of England, and they would want to feel free to keep in touch with their own countries. Yet they must be given a status equally

as high as United Kingdom nationals concerned with the direction of the note issue. An independent Currency Board on the lines described therefore offers an equitable solution.

WORK OF THE CURRENCY BOARD

The Board will have offices in the Bank of England, which it will occupy free of charge. It will have to meet and consider such data as it deems suitable in order to regulate the volume of fiduciary currency in circulation. For this purpose it ought to be in a position to obtain statistical matter of the nature dealt with in Chapter V of the Report of the Committee on Finance and Industry (1931). It should be entitled to call upon any member of the Bank of England's staff for material it requires, to appoint its own economic staff, or to requisition the services of the Intelligence Departments of other banks upon making suitable arrangements with their directors for their compensation.

At fixed intervals, say once every two months, the Currency Board will issue its decision as to the amount of the fiduciary issue of Bank of England notes to be permitted for the ensuing two months. This will be posted up immediately on the bulletin board of the Bank of England and subsequently published in the *London Gazette*. The Bank of England will adapt its note-issue position accordingly, and co-operate with the Currency Board in preparing to expand its discounts at an agreed rate or to enlarge its open-market purchases in such a manner

as will give full effect to the conclusions arrived at by the Currency Board. This, of course, assumes that the Currency Board decides for an increase in the fiduciary issue. If its decision were in the opposite direction, the Bank would fall in with such opinions regarding contraction as the Currency Board may convey to it via the Governor of the Bank. Particular care will have to be exercised by the Board when it has to consider a persistent tendency towards a fall in the price level of any one country, or of all, which may be due to technical improvements in industry.

Note Cover and Profits on the Fiduciary Issue

At the outset of the scheme, Parliament will have to give its consent to the general details. These will include the type of cover which will have to be held against the fiduciary issue, which may not differ extensively from the securities at present utilised for this purpose. The Issue Department should be merged with the Banking Department, as favoured by the Macmillan Report, for the note-issue account would continue to be kept in the books of the Bank, and would always be accessible to the Currency Board. The cost of the Currency Board, insofar as it fell on Great Britain's shoulders, would be charged against the profits on the fiduciary issue. The Bank of England would make transfers among its assets which would conform with the requirements of the Currency Board as to the nature of the fiduciary note cover. For this service an agreement should be drawn up between the Currency Board,

the Treasury and the Bank allowing for a payment to be made to the Bank out of the fiduciary note cover profits. The earnings of securities earmarked for this purpose are to be under the supreme control of the Currency Board, which will make all disbursements against them allowed by law, and transmit the net balance to the Treasury at the end of an accounting period.

Bank Rate should continue to be fixed by the Bank Court. Any proposed changes must be submitted to the Currency Board, whose consent by a majority vote will be sufficient to confirm the alteration. The Board itself, however, may initiate a change of Bank Rate providing its opinion, excluding the Governor of the Bank of England's vote, be unanimous, in which case the Bank would be under statutory obligation to comply immediately.

REDEMPTION OF BANK NOTES IN GOLD BULLION

The Bank will stand prepared at all times to purchase gold bullion at the price fixed by Act of Parliament. Should demands be made for gold bullion against notes tendered, payment by the Bank will not be as free and unqualified as in the period 1925-31. Any person or firm asking for gold will have to satisfy the Currency Board that it is intended for export to, or for earmark in London on behalf of, countries which are already linked up in the monetary standard agreement. These countries will have undertaken that any gold movements

arising out of temporary deficiencies on the balance of international payments will be allowed to work out the full "normal gold standard" effects in the countries concerned. The country losing gold will contract credit, and the one gaining gold will expand bank accommodation until equilibrium is once more achieved. In order to deal with requests for gold redemption for this purpose—and for no other will it be allowed—a small sub-committee of the Currency Board will be appointed to attend daily at the Bank of England, the employees of which must refer all such requests to it.

Where the gold is wanted for export or earmark on behalf of any country outside the monetary agreement or any ancillary arrangements, redemption will be refused. It is possible that to begin with this provision may rule out earmarkings or shipments from the gold behind the note issue on behalf of France and the United States. If these countries adhere to a monetary system of the type prevailing in February 1933, the franc and dollar exchanges would remain reasonably steady should the authorities in the United States and France succeed in carrying through any measures economising the use of gold which would assist in stabilising its value. If gold once more tended to rise in value, however, the countries within the Commonwealth monetary agreement would have the satisfaction of knowing that price levels within their own areas would not copy the full fury of the downward movement in France and the United States, owing to the ban on movements of the gold behind the note issue to those countries.

But it should be remembered that the desire for a steady level of the exchanges is not one-sided, and when France and the United States observe the definite creation of the Commonwealth stability scheme they may not tarry in contributing their share to a general movement towards the maximum possible amount of exchange stabilisation, though they may not necessarily be prepared to follow along the lines of the British scheme. Some form of arrangement with them regarding gold movements may then not be impossible. Should this be arrived at, perhaps it would be wise to incorporate in its terms the stipulation that should the wholesale commodity price index within France or the United States decline by more than a given percentage from its initial level over a defined period, the British would have the right to suspend gold movements (from the note cover) to that country, and the country concerned would not treat this as an unfriendly act. This provision, of course, could apply to both contracting parties. Should price levels ever tend to move below the agreed points in two or more countries the broadest national and international interests would demand a joint consultation, at which each country would attend with its freedom and right of action in the matter of the currency standard completely reserved.

The bullion market in London would continue to work as freely as at present, and gold purchased in the market could be exported at any time by the buyers without a licence. Gold imports for disposal in London would remain without official hindrance.

Gold held under earmark by foreign monetary authorities in London would likewise be accorded unhampered movement providing the Currency Board were given a formal notification. In these circumstances a marked increase in gold production relative to monetary and commercial needs would probably lead to a drop in the metal's price in the London market. A level may be reached at which it would pay the sellers to dispose of the gold to the Bank of England at its statutory buying rate—and it cannot refuse to buy. The Commonwealth monetary area would thus, should the Currency Board acquiesce, not escape the tendency to a rise in price levels owing to a plentiful world production of gold. On the other hand, however, it has already been explained that the Commonwealth area may hope to escape the greater part of a fall in price levels through insufficient gold production. Open-market prices for gold in London would in that case move more freely, in a somewhat similar manner to their unpegged experience of 1932, with foreigners the probable buyers most of the time. Unless price levels in gold standard countries fell away at an alarming pace, it is not likely, however, that bullion market prices for gold would fluctuate with their phantasmagoric unsteadiness of last year. Sterling prices for gold then responded closely and inversely to the United States dollar or the French franc quotation for the British pound. Many of the influences playing upon the exchanges at the time were of an abnormal political and commercial type, and it must reasonably be expected that the passage

of time will eliminate the majority of these extraneous factors. The gold mines themselves should find every safeguard under the new system, for they would remain free to seek the most profitable market for their product. If the value of gold fell because of increased production, they would always be able to dispose of it to the central banks at their statutory buying rates. And if gold rose in value, or, in other words, price levels in gold countries fell, the mines would still be in a position to dispose of their metal to the gold central banks, or at a premium in the "new stabilised gold countries."

A few formal precautions will have to be introduced if the above scheme is incorporated in British law. Parliament may consider it necessary to place the Bank of England under statutory penalties if it fails to comply with such instructions of the Currency Board as the law obliged it to carry out. Another risk to be averted lies in the fact that political interests may tend to manœuvre for membership of the learned societies, the Councils of which will have the right to nominate United Kingdom members of the Currency Board. The membership qualifications should be carefully scanned and approved by Parliament or the Privy Council. Finally, some provision for the settlement of any dispute between the Currency Board and the Bank of England, whether it be over a matter of small detail or not, should allow for its reference to such a body as the Judicial Committee of the Privy Council.

CHAPTER VI

THE ADVANTAGES AND POSSIBILITIES OF EXTENDING THE REFORMED GOLD STANDARD AREA

A NUMBER of virtues can be claimed in support of the scheme in addition to those already mentioned in the course of this essay. The Currency Board proposal would not nationalize the Bank of England, and the greater degree of independent yet representative control over the note issue which has been outlined would remove the dangers of pure political control. No reason exists for doubting the abilities and willingness of the Bank's directorate and staff to co-operate with the Currency Board in the technical working of the note-issue system. The proprietors of the Bank have likewise come to accept the national obligations laid on their institution as socially exigible. Providing sufficiently adequate safeguards were attached from the outset to the system of election to the Currency Board, all the elements of permanence would appear to hover around the cradle of this new bi-cameral monetary system within the United Kingdom. In time of war or serious national crisis, however, it may be taken for granted that the Government of the day would generally insist on certain measures being taken, as it has done in the past. The creation of the Board allows the Bank of

England to continue to work along its normal lines, and to earn the usual rate of return for its shareholders. No sweeping interference with its earning capacity or its relations with overseas central banks appears to be involved. It will continue to hold the Government funds and manage the National Debt. It will, as at present, remain the depository of such central banks as choose to maintain balances or earmark gold with it in London. Furthermore, its officials will not be expected, either now or in the future, to relinquish their contacts with overseas monetary centres. An understanding will have to be arrived at, before the monetary scheme described in earlier pages is set up in its entirety, as to the precise delimitations of overseas relations for both the Board and the Bank. The Governor of the Bank of England will at no time when he journeys abroad have authority to commit the Currency Board, unless he is expressly authorised to do so by the unanimous vote of that Board. It would be desirable that, on every occasion when a high Bank official takes part in conversations having a bearing on monetary policies with overseas monetary authorities, it should be an established rule that he be accompanied by at least one other voting member of the Currency Board, whose presence or views there expressed must in no way be taken by the foreign authorities as committing the Currency Board to any line of policy. Acceptance by the Board of any conclusions arrived at as the result of such discussions cannot be taken as complete until the Currency Board has agreed to them by

majority voting. Further, as a matter of courtesy, the Bank would be expected to keep the Currency Board informed through its Chairman of any dealings it may have with overseas currency authorities which may be of material interest to the British currency controllers. In the unlikely event of the Board learning that the Bank had not made a full or any disclosure of this type, the Currency Board must be invested with statutory powers to demand and be furnished with the information desired, and should it deem the matter to be of national importance, the Board may report the matter to Parliament. The purport of any parliamentary debate which may ensue would offer useful guidance to both parties in smoothing over the difference of opinion. If after this the Bank repeated its refusal to deliver a full measure of information to the Currency Board on the grounds that it was not material to the work of that body, the decision of the Judicial Committee of the Privy Council, as suggested earlier, should be binding on both parties.

Another feature of its work which the Bank would naturally be relied upon to continue under the new régime would be its *role* of central support for the money market, as well as head of the British banking system. In short, therefore, after allowing fully for the delicacy of adjustments which must be made in order to discriminate precisely the working relationship between the Board and the Bank, no loss of prestige on the part of the British central institution is implied in the creation of this new agency, nor does any desire to minimize or sabotage

the Bank's most valuable international banking connections underlie the new scheme. The Bank of England would remain a vital complementary part of the British monetary system. It is one of those institutions which cannot be uprooted, but must be adapted. Time is merely wasted if it be fought as a malignant ogre.

THE UNITED STATES AND STABILIZED CURRENCIES

It has been suggested that some derivative of the British Commonwealth scheme may be introduced into other currency areas, and that the United States may well take the initiative for one of these. It does not appear feasible to introduce widespread grouping on the Commonwealth model into any related versions of the Currency Board idea in other geographical areas. The basis of a common Crown, a common Motherland, and blood ties and financial links which join up an Empire whose representatives have nowadays acquired the habit of consulting together every few years over their groupal problems cannot be duplicated on a parallel scale in the present world. United States opinion would never allow nationals of any other country or territory to sit on the Federal Reserve Board or any Currency Board (within the country) which it may be decided to form. This standpoint demands respect. But there is nothing to prevent the United States from designing its own machinery for working a monetary standard of the Commonwealth type, and assuming the leadership in inducting its own possessions, the

Philippines, Mexico and most of the Central American states into the new means of holding exchanges and price levels. As the foremost financial Power of this group, and as a country whose financial centre rivals London alone, the States could then invite the Commonwealth Currency Board to negotiate with it an agreement governing gold movements. Both sides would demand as prerequisites that, as in the Commonwealth agreements, the currency authorities in each of the countries concerned are definitely in charge of the note issue and in control of credit; that political interference, particularly in the form of a removal of currency controllers from office before their term has expired, can be adequately withstood; and that the method of selecting those currency controllers is sufficiently discriminating as to secure that only men eminently fitted for that type of duty are awarded the posts. In this way, given an effective agreement, the British Commonwealth currency area and the United States monetary sphere would tend to dominate world trade. Between them they carried out 42½ per cent.¹ of the world's trade by value in 1930.

¹ To arrive at this figure the British Commonwealth area is taken to comprise the Dominions, colonies, Anglo-Egyptian Sudan, protectorates and mandated territories, which together had 27·7 per cent. of the world's trade by value in 1930. The United States currency area has been taken as including the United States, Philippine Islands, Mexico, Cuba, Costa Rica, Dominican Republic, Haiti, El Salvador, Panama, Nicaragua, and Guatemala, which altogether did 14·51 per cent. in value of the world's trade in 1930. If to these two currency areas be added a South American group including Argentina, Brazil, Chile, Colombia, Peru, Paraguay, Venezuela, Bolivia and Uruguay, as well as Sweden, Norway, Denmark, Finland, Portugal and Siam, the total proportion (by value) of the world's

The States stand out as potentially the heaviest lenders of long-term capital in the world, since it now appears that for a number of years Britain will be unable to challenge the United States' surplus on visible and invisible trading account once world conditions have become more normalised. Britain, however, because of long experience in world-wide trade affairs and her advanced type of money market, which has fully held its own for many years, should stand pre-eminent in the short-term financing of foreign trade and as a centre for the employment of floating international balances—not that the latter can be a tranquillising factor if of an unwieldy magnitude. It has been found during the past eighteen months, and has furnished a thorny subject for discussion by both primary producers and manufacturers abroad who look to countries at present in a sterling area for their principal overseas markets, that sterling by itself wields a potent influence on the prices they can obtain for their products. If, therefore, a Commonwealth area were linked monetarily to the United States area, the outcome should be a dominance of the world price level by these two parties to the new monetary arrangements, and hence a tremendous step forward to an enduring stability of exchange rates and price levels.

trade undertaken by all the countries which would be affected by the new currency arrangements amounted to just over 52 per cent. in the year 1930. The statistics used are taken from the "Review of World Trade, 1931 and 1932 (First Half)," published by the League of Nations.

SOUTH AMERICAN CURRENCIES

With or without this understanding between the two outstanding sets of world monetary authorities, it is likely that a number of countries may wish to achieve stability against sterling or the United States dollar. South America raises some intriguing questions in this connection. Professor Kemmerer of Princeton University has in the post-War years carried out the duties of monetary doctor for a number of countries in this southern continent, including Peru and Chile. It is true he advised the latter country in 1925 to stabilize its peso on a gold exchange basis against the pound sterling. Brazil, however, called in Sir Otto Niemeyer of the Bank of England as a monetary adviser in 1930, whilst the same official was invited to pay a visit to Argentina in the early part of 1933. These two countries, the two foremost trading nations of South America, have therefore shown predilections for British advice. During a number of months in 1932, however, both these countries carried through with some success—with notable success in the case of Brazil—a policy of holding their exchange rates against the American dollar, at a time when various alarms and excursions arising from debt payments, speculation, War Loan repayments, seasonal pressure, dammed-up export proceeds abroad, and falling prices in "gold" countries kept sterling skyrocketing to and fro in terms of the United States dollar and the French franc.

If the United States and Commonwealth areas have succeeded in settling upon a link between the currencies of their "associated" countries, as well as upon the terms of gold movements, there is little doubt but that the majority of South American states will come to an agreement joining their own systems upon the new conditions, or by exchange standard methods, to the Commonwealth-American scheme.

Two sets of circumstances have to be distinguished, however. In the event that the United States and Commonwealth groups reach a workable understanding, a method by which South American states can join up with the reformed gold standard scheme will have to be devised. Negotiations may take place between individual countries and fully empowered representatives of the effective monetary authorities standing at the head of the United States and Commonwealth groups. It may be wise to utilise the position at present enjoyed by the Bank for International Settlements by drawing upon its directorate for a neutral chairman of any conversations held. This bank, moreover, can serve as a useful diplomatic buffer to protect either party to the conference from the dangers which it may fear, but which for delicate political reasons it may not care to indicate too pointedly, through a monetary system within a negotiating state not being satisfactorily disentangled from local politics. An appeal can be carried to the Board of the B.I.S. as to whether the monetary system of a given country is thoroughly established—that is, do the central

bank and note-issuing authorities substantially function as such without extraneous hindrance? Even though the predominant opinion of the B.I.S. Board may be against the new type of gold system, the directorate should be fully capable of delivering a considered and impartial judgment on these matters of fact. If the verdict did not favour the country concerned, the Commonwealth-American system areas could suspend the negotiation of an agreement governing gold movements between Commonwealth-American area countries and the South American state, and alterations could be demanded before discussion would be resumed with the latter. Such a decision would by no means thrust the South American country without the pale of a stable monetary area. It could still institute an exchange type of standard based on devisa balances held in London or New York. Indeed, in this manner a most effective stability against the U.S. dollar and sterling could be preserved.

Another means of securing the entry of South American states into the revised gold scheme would be for as many of them as possible to agree first of all at a Hispanic American Monetary Conference over the provisions for the working of a comparable system among themselves. With these details settled, they could then approach the Commonwealth-American groupings, either through a joint committee, or more probably one at a time, and settle the conditions of gold movements. The treaties signed by them would to a large extent be of one pattern. The inclusion of a wholesale price index deviation

clause allowing for the cessation of gold shipments whenever these indexes in a contracting country fall below their initial level by more than a given percentage would furnish a valuable safeguard against a tendency to unnatural gold drains arising from deflation, or the inadequate management of a creditor position on the balance of international payments in the gold-attracting country.

A second possibility lies in the fact that the United States may decide that a monetary system approximating to their pre-March 1933 version remains adequate for their needs, and that consequently they do not feel disposed to enter into any monetary "understandings" or contracts with foreign powers and their monetary officials. This attitude, of course, would not exclude the United States from taking a number of steps on their own which would lighten their bulk demand for gold for monetary purposes. They might, for instance, lower their required gold reserve against Federal Reserve notes from 40 to 25 per cent. and against deposits and sight liabilities from 35 to 20 per cent. As explained on earlier pages, such actions by a number of countries would undoubtedly prolong the valid working period of their present gold standards. But if the States and, of course, France stand out of a monetary arrangement along Commonwealth lines, the question of the British approach to a number of South American countries will arise. Invitations extended to these states to participate in a general conference, or a series of conferences, in order to explore the possibilities of a working agreement

covering gold movements, or sterling exchange standards, or co-operation with a view to obtaining the maximum amount of exchange and wholesale price level stability among the countries concerned, may not prove fruitless in a number of instances. British financial prestige would scarcely be besmirched as a result of leadership in this matter. Trade considerations may quite likely induce at least Argentina, Paraguay, and Uruguay to link up more closely to the sterling area, and less likely things could occur than that Brazil and Chile should follow their example.

EUROPEAN STATES AND A REFORMED GOLD STANDARD

No suspicion of group formations can be allowed in any counterparts to the new plan which may be adopted by continental European countries. The suggestion that the Latin countries of France, Belgium, Spain and Italy should revive a Latin Monetary Union, whilst Central European countries like Holland, Germany, Austria, Switzerland and Czechoslovakia enter into a "monetary association" under the nominal ægis of the Reichsbank, would be both fantastic and dangerous. In the first place, Europe contains too many central banks and bankers who play leading parts in world monetary affairs for a few chosen ones to be given a nominal primacy in arranging the reformed gold system. France, Germany, Holland, Italy and Switzerland must all be accorded equality of central banking status *ab initio*.

One congeries of countries round the Banque de France and another round the Reichsbank would merely tend to perpetuate the " bloc " idea in Europe and foster political rivalry. The world is not interested in assisting Germany and France to link foreign politics with currency policy to a more marked degree than is at present the case, and thence to indulge in a strenuous rivalry for the favour of other powers which they may hope to coax into the position of currency satellites. Further, a number of countries which on geographical or ethnographical grounds might be expected to join in with one or other of the regional groupings may prefer to fashion more direct links with sterling by means of a bilateral treaty. States like Portugal, Estonia and Latvia, which have already developed the practice of utilising sterling devisa as a currency support, and which realise the importance for them of the United Kingdom market, may be said to enter into this category.

Such European countries as wish to unite monetarily with the stable sterling, or sterling-dollar, area should therefore undertake direct individual negotiations with the British Currency Board, the British Treasury and the Board of the Bank of England and the equivalent bodies in the American " currency area." Foreign nationals, of course, would never be allowed any say in the conduct of the British Currency Board. The outcome of the joint discussions would therefore be a monetary treaty the general tenour of which would resemble those already described between the British and

American groups, or, with modifications, between constituent Commonwealth countries. All these treaties should be deposited with the Bank for International Settlements, which, incidentally, might in the majority of cases be requested to nominate a chairman for the preliminary conferences. Where both parties to the subsequent monetary treaty are already officially linked up in the B.I.S. by shareholdings, the terms may allow for an appeal to the B.I.S. by either party to decide the factual accuracy of an alleged breach of the obligations undertaken. As already mentioned in the discussion on South America, the B.I.S. could also serve the useful purpose of giving an impartial opinion when called upon by a negotiator to say whether a country's banking and currency organisation was watertight—that is, unhampered by the predominance of political meddling.

If Europe has not moderated its network of exchange clearings, discriminatory quotas and high tariffs, and exaggerated foreign exchange control by the time that the opportunity for monetary stabilization arrives, the United Kingdom would be in a strong tactical position for forcing a mending of ways under the new system. Joined with the United States "circle," the British position would be far more than doubly strong. Continental countries desiring stability in the new association could be refused discussion unless their manoeuvrings for a form of economic autarchy were brought to a halt. Without the United States, as well as France, the Commonwealth's strategic conference position

would by no means be lost. Secure in the capacity of the British authorities to manage their gold standard, diplomacy on the part of the Commonwealth should still enable its member states to obtain a freer set of conditions for their international trade and finance in those countries where it is felt to be necessary. Statesmanship could scarcely prove unequal to this task, whether overtures for a monetary agreement came first from the United Kingdom or the foreign country.

It has been mentioned that any negotiations should be undertaken from the Commonwealth side jointly by the Currency Board, the British Treasury and the Board of the Bank of England. A diplomatic team of this nature does not mean that the weight of opinion held by the Dominions on the Currency Board has been discourteously ignored. It can be taken for granted that the Treasury representatives, nominated by the British Government, will be fully competent to handle all facets of the political questions which arise in the course of the discussions. Their authority will be so arranged that, after reference, their signatures bind the British Government *only*. The original act setting up the Currency Board, however, must contain a clause which grants that no international monetary agreement that may be drawn up shall be binding on the Board unless its own representatives have taken part in the original conferences and it has subsequently been accepted by at least a two-thirds majority vote of the whole Board. At this point the Dominions would assert their voting strength. As a further satisfaction

of Dominion requirements, the provisions of the monetary treaty would not be binding on individual Dominions until their own Governments had officially signified consent and the Central Bank or supreme monetary authority of the country had likewise accepted it. In the case of the United Kingdom, the Board of the Bank of England would also be required to approve of the treaty before its applicability would be valid.

No certainty exists that either or both the United States' circle and France would be joined to the sterling gold system in the manner described. The position of the Commonwealth in this eventuality has been briefly touched upon on pages III-III2. Should the United States arrive at a satisfactory agreement with the Commonwealth group, it is likely that most South American countries, Japan, Scandinavia and a number of European states, whose external obligations in dollars and sterling would form a principal motive, would ultimately associate themselves with the monetary concordat. In these circumstances it would be to Germany's advantage to join in too, even though France, Holland, Belgium and Switzerland may prefer to adhere to a gold standard of their present type. Germany's example would undoubtedly influence a number of other Central European and Danubian countries to follow her. Scandinavia, it is assumed, would speedily enter the stability plan, while Italy should not find it difficult to re-orientate her currency ideas in view of the country's freedom from heavy short- or long-term external indebtedness

and its reasonably satisfactory balance of payments position.

A searching question crops up when the position of European states has to be examined if both the United States and France abstain from the scheme. Scandinavia should find every inducement to join with the Commonwealth area, particularly in view of the importance of the United Kingdom market for Denmark, as well as Sweden's successful experiment in preserving price stability within her borders during 1932. Finland may not stand out against the attractions of the step taken by her Baltic neighbours, whilst, in view of the close financial connections in the past between the United Kingdom and Portugal, the latter country may be expected to tread the path of greater stability.

AN ANALYSIS OF GERMANY'S POSITION IN RELATION TO THE SCHEME

The most important acquisition would be Germany, if that country decided that the balance of advantage for her lay in joining with "the gold sterling" area. The number of states that would follow in her wake on the continent of Europe warrants a close analysis of the factors which would bulk largely in Germany's mind when weighing her choice. Granted that after the Lausanne Agreement of 1932 the payment of Reparations to the Allied and Associated Powers does not revive on anything approaching the Young Plan scale, the Reich would not feel the urge to collect as much foreign exchange in the form of long-term loans as it did during the seven years

from 1924 to 1930, when, according to the figures given by the Wiggin Committee in August 1931, 9.1 milliard Reichsmarks were taken up in long-term loans from abroad, whilst 10.3 milliard Reichsmarks were paid across German frontiers to meet Reparation undertakings. At the same time, it must be remembered that Germany found a use for 6.2 milliard Reichsmarks of foreign short-term credits over this seven-year period, most of which came from Great Britain, the United States, Holland and Switzerland. The short-term credits outstanding were reduced to some extent in the early part of 1931, prior to the first standstill agreement. As trade revives, however, Germany will require a measure of short-term credits to resume her full status as a trading nation. Though her creditors have received numerous shocks and for the most part have their loans to Germany frozen for a period, it is probable that when conditions have eased and the stringency of Stillhalte pacts has abated, first-class German names will be able more freely to obtain foreign money and foreign acceptances on their traders' and bankers' bills. The lenders, however, will scarcely offer their funds in the same volume as formerly, whilst their ideas of the rates to be charged may also have undergone revision in a less competitive loaning atmosphere. For this money, Germany, judging by past experience, will have to continue to turn mainly to the United States, Great Britain, Switzerland and Holland. American politicians have recently enjoyed an investigating picnic on the question of foreign loans, and the aftermath may well

be a spirit of hesitation or more circumspection, when handling foreign business, in both the American short- and long-term lender's mind. Britain, too, has learnt in 1931 and 1932 the caution which must attend her foreign lending until such time as her balance of international payments can be brought back to a 1928 or 1929 position—if that ever again be a feasible task. The British Government's ban on new capital issues for foreign countries in 1932 in reality had a wider basis than the necessity for smoothing the way of the War Loan conversion. The country was not in a position to make these loans, unless their proceeds were to be spent wholly within the country, since its current credit balance on international account had vanished entirely, and had been actually replaced by a reduction in our net capital position vis-à-vis other countries. It is possible, therefore, that for some years to come some form of oversight of long- and short-term loans to abroad, following the suggestion of the Macmillan Committee regarding the collection of statistics on these matters, will be instituted in this country. London should, indeed, be prepared for this move, since its object will be an adequate defence of the national interests. It will not result in Germany's being completely excluded from using London funds, even if that were desirable. If London is to retain her supremacy as a short-term financier, some of her money must be utilised by Germany, and with a trade revival in Germany will come an expanding movement in a number of central and south-eastern European

countries closely linked with her in trading and financial matters. Britain has gains to make, both directly and indirectly, from this happy turn of events. Despite the tighter fists which Germany may meet in approaching British and Americans, there is little doubt that she will feel impelled to come to foreign markets for some accommodation. In addition, the service of the 1924 Dawes Loan and the 1930 Young Loan has involved her in commitments in foreign *gold* currencies, principally U.S. dollars, sterling, French francs, Swedish kronor, Dutch florins and Swiss francs. She must also respect her existing liabilities to foreigners on both long- and short-term account, and the numerical division of these between the principal currencies. A glance at this latter position will give an indication of the countries whose exchange will be a principal requirement of Germany, whether for repayment or dividend and interest purposes. The Wiggin Committee of August, 1931, was supplied with these details by the Reichsbank, and incorporated them in its Report ¹ to the Bank for International Settlements on the credit situation in Germany. These figures, however, were subsequently overshadowed by the results of an extensive inquiry conducted under an official decree by the Anmeldestelle für Auslandsschulden, Berlin, in the early part of 1932.² The outcome of its investigations must be accepted as the latest available, with the mental reservation that to a slight extent some alteration in a contractionary

¹ Supplement to *Economist*, August 22nd, 1931.

² See *Wirtschaft und Statistik*, published by the Reich Statistical Office. 2 August-Heft, 1932.

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sense will have taken place since February 29th, 1932, the selected date for which an exhaustive declaration of foreign debts had to be made. All these overseas obligations were converted into Reichsmark at the middle rate in Berlin on February 29th, 1932. Whereas in previous inquiries on foreign indebtedness only amounts above 50,000 Reichsmark had to be declared, in this investigation the minimum amount to be reported was lowered to 5,000 Reichsmark. This more comprehensive enumeration produced the following summarised results :—

**GERMAN FOREIGN INDEBTEDNESS DIVIDED UP BY
CREDITOR COUNTRIES**

In million R.M., at Berlin exchange rates on Feb. 29th, 1932.	Short Term Credits.	Long Term Loans.	Total.
United States	3,227	5,165	8,392
Netherlands	1,661	1,914	3,575
Switzerland	1,615	1,146	2,761
United Kingdom	1,286	1,129	2,415
France	474	482	956
Sweden	136	167	303
Belgium	119	80	199
Czechoslovakia	157	18	175
Italy	73	74	147
Denmark	51	9	60
Norway	14	5	19
Miscellaneous Countries * .	1,340	281	1,621
Totals	10,153	10,470	20,623

* Including the B.I.S. investments in Germany and the credit granted to the Reichsbank by the B.I.S., Federal Reserve Bank of New York, Bank of England and the Bank of France. The outstanding balance (\$70 million) of the B.I.S. credit was repaid on April 8th, 1932. In addition, \$25 million of the Lee Higginson credit had been paid off by that date, whilst some repayments to creditors under the terms of the Standstill Agreements have also been made.

These figures, however, constitute past commitments which Germany will have to meet to the best of her capacity. Her resources for this purpose will rest fundamentally, despite her tourist attractions and shipping fleet, upon the trend of her merchandise trade figures in the future. It is a matter of great concern for that country that the volume of world trade should expand to a more normal size. Accordingly, Germany will doubtless endeavour to contribute her full share to the orderly resumption and maintenance of international commerce. As a nation whose main exports fall into the manufactured goods class, it would be good politics as well as good economics to keep the factories and mills of the towns well filled with active humanity. Germany cannot afford to neglect the far-flung trading area of stability that may reasonably be expected to form itself soon after the British Commonwealth has taken the initial steps. For this reason it is instructive to analyse the statistics of Germany's merchandise trade over the three years 1929-31 with those countries which may be assumed to enter the "gold stability" area almost from the start, and this has been done in the tables on pages 136 and 137.

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GERMAN FOREIGN TRADE ACCORDING TO COUNTRIES ¹

(Values in Millions of Reichsmark.)

	Imports.			Exports.		
	1929.	1930.	1931.	1929.	1930.	1931.
<i>Europe:—</i>						
British Mediterranean Possessions						
Great Britain	4.4	3.8	3.7	7.4	5.4	5.0
Irish Free State	865.3	639.0	453.3	1,303.3	1,218.9	1,133.6
Denmark	2.2	1.1	1.2	24.9	18.8	13.5
Finland	370.5	296.5	182.9	483.3	477.1	360.7
Norway	115.9	84.9	43.7	188.2	137.5	90.7
Portugal	143.2	106.4	61.2	226.6	207.0	162.4
Sweden	37.6	27.2	21.8	63.7	64.8	40.4
Sweden	350.3	304.1	158.1	475.7	494.2	424.7
Total: "Sterling" area above	1,889.4	1,463.0	924.9	2,775.3	2,623.7	2,240.0
Total: Whole of Europe	7,066.5	5,825.0	3,763.5	9,924.1	9,377.2	7,777.8
Percentage of "Sterling" to all Europe	26.7	25.1	24.5	27.9	28.0	28.8
<i>Africa:—</i>						
Egypt	78.1	58.6	48.3	82.9	65.1	43.4
British East Africa	29.4	16.7	12.0	8.4	6.0	3.2
Tanganyika	6.3	6.4	1.5	6.5	4.2	1.7
British South Africa	164.4	92.9	58.7	95.8	76.5	62.6
South-West Africa	9.8	6.9	4.6	9.0	6.7	2.7
British West Africa	179.4	160.8	105.0	29.7	22.8	10.0
Portuguese East Africa	10.6	16.0	2.8	12.5	12.4	6.7
Portuguese West Africa	8.8	7.4	4.4	7.4	4.7	2.6
Total: "Sterling" area in Africa	486.8	365.7	237.3	252.2	198.4	132.9
Total: Whole of Africa	686.4	527.5	344.6	311.9	268.1	184.2
Percentage of "Sterling" to all Africa	70.9	69.3	68.8	80.9	74.0	72.1
<i>Asia:—</i>						
India	623.7	428.6	280.5	220.4	190.0	157.5
British Malaya	35.3	29.3	18.7	26.1	13.1	7.4
Ceylon	30.2	21.0	14.4	9.3	3.5	3.9
Palestine	3.9	7.6	6.2	11.7	11.9	9.5
Siam	7.9	3.7	2.4	14.8	10.3	6.6
Total: "Sterling" area in Asia	701.0	490.2	322.2	282.3	230.8	184.7
Total: Whole of Asia	1,605.1	1,216.8	833.5	1,041.8	804.2	639.9
Percentage of "Sterling" to all Asia	43.7	40.3	38.6	27.1	28.7	28.8

¹ *Wirtschaft und Statistik*: 1932. 1. März-Heft, p. 138.

GERMAN FOREIGN TRADE ACCORDING TO
COUNTRIES (*contd.*)

	Imports.			Exports.		
	1929.	1930.	1931.	1929.	1930.	1931.
<i>America</i> :—						
Canada	303.1	132.6	99.1	84.8	70.2	47.2
Rest of British America	73.0	96.4	55.4	5.8	6.5	5.1
Argentina	744.7	403.0	208.7	371.3	287.4	174.0
Bolivia	8.6	8.1	7.6	12.1	9.3	3.8
Brazil	214.9	155.9	123.1	210.2	120.7	66.7
Paraguay	1.8	1.8	1.2	3.0	3.0	1.8
Uruguay	40.8	36.4	36.0	38.5	37.7	25.1
Total: "Sterling" group in America	1,386.9	834.2	331.1	724.7	534.8	323.7
Total: Whole of America	3,711.8	2,543.6	1,601.8	2,093.2	1,512.3	954.6
Percentage of "Sterling" to all America	37.3	32.8	33.2	34.7	35.3	33.9
<i>Australasia</i> :—						
Australian Commonwealth	313.6	205.6	121.1	84.3	48.3	21.5
New Zealand	27.3	21.6	20.8	12.0	12.4	8.4
Former German Pacific Possessions	0.0	0.1	0.0	0.4	0.9	0.2
Samoa	0.7	0.3	0.2	0.1	0.0	0.0
Rest of Australasia and Polynesia	8.0	6.6	8.4	3.9	2.9	5.5
Total: "Sterling" area in Australasia	349.6	234.2	144.5	100.9	64.5	35.6
Total: Whole of Australasia	349.6	234.2	144.5	100.9	64.5	35.6
Percentage of "Sterling" to Australasia	100	100	100	100	100	100
Total Trade with the World (incl. miscellaneous)	13,446.8	10,393.2	6,727.0	13,482.7	12,035.6	9,598.6
Trade with World "Sterling" Group	4,813.7	3,387.3	2,160.0	4,136.4	3,652.2	2,916.9
Percentage of "Sterling" to World	35.8	32.6	32.1	30.6	30.3	30.4

Taking Germany's trade with the whole of the world, it will be seen that 32 per cent. of her imports and 30 per cent. of her exports concern lands which

will be linked up in the area assumed to be pivoting round sterling, and covered by the agreements intended to stabilize price levels and exchanges. Germany likewise must feel urged to reach out for the greatest amount of exchange steadiness in order to hold her trade figures at the maximum point to which a new-found world confidence may tend to raise them. In view of her financial obligations to the United States, the Netherlands and Switzerland, there is no irresistible certainty that she will be moved, through trade reasons and financial connections with London, to enter the reformed gold scheme if both France and the United States hold aloof. At the same time, she cannot afford to have her currency fluctuating too erratically in terms of sterling and its associated exchanges. She would almost be caught between two stools. The most helpful solution would come from a definite settlement between the German monetary authorities and the countries attached to the Commonwealth area as to the conditions of gold movements between them, with either party absolved from permitting gold exports to the other if wholesale price levels fell by more than a given percentage below their initial indexes. Such an agreement would meet the innate German fears which attend any slight move away from a gold currency of the present type—fears which at once engender the belief that the horrors of inflation are about to descend upon the land once more. Under the new monetary conditions the Reichsmark would maintain its present gold value and, in fact, gold redemption of Reichsbank notes

would be continued according to the terms of Dr. Schacht's letter¹ to the Chairman of the Young Committee in June, 1929, agreeing to secure that Section 31 of the Bank Law of August 30th, 1924, should be put into effect. Although the Young Plan has been provisionally scrapped by the Lausanne Agreement of 1932, it is not assumed that Germany will forthwith expunge this undertaking with regard to convertibility. Yet, at the same time, acceptance *in toto* of the Lausanne Agreement would appear to give her greater freedom of action in currency matters, since the type of gold standard to which Germany adheres would no longer form a contractual stipulation of an effective Young plan. Thus, if American and French claims, to the effect that a gold standard approximating to the pre-March 1933 pattern can be worked so that it contains simultaneously stability of price levels and exchange rates between gold countries, should prove well-grounded, Germany would find herself in the midst of a company of almost immaculately stabilized nations. There would then be two predominant types of stable monetary systems in the world, the one evolved by London, and this repentant Gallic and American gold standard. Mankind may well indulge in a contemplative speculation as to which of these two is more likely to break from its anchorage the first—whether it will be the one which depends solely on metal supplies and the method of their utilisation, or the

¹ Annex II to the Report of the Committee of Experts on Reparations, June, 1929. Cmd. 3343.

structure which has progressed beyond factors so unreliable in the long run.

Germany herself, however, would in these circumstances not be faced with difficulties unless gold price levels once more fell away with the full political and social fury of a steep decline. Her economic problems of to-day may not be the same as those of this hypothetical future of misfortune, and changed conditions would quite possibly find her preferring to hold to the stability of the Commonwealth and its related currency systems, and not attempting to adjust prices, wages and the standard of living downwards by compulsory methods in order to maintain a respectable equilibrium with gold countries of the old school.

PRICES OF UNITED STATES' CROPS AND EXPORTS

The difficulties of negotiations with the United States regarding war debts should not be allowed to colour the fact that that country remains profoundly interested in the form of a sterling stabilization scheme. So long as this has not formally been achieved, sterling exchange quotations stand exposed to the effects of political hitches, speculative interpretations of financial developments, and higher and lower sweeps than usual at times of seasonal buying and selling pressure. The Exchange Equalisation Account may, of course, serve to modify all these. But insofar as the workings of such causes have depreciated the value of sterling against the

dollar, the difficulties of both United States farmers and manufacturers have been intensified, particularly in the period prior to the American suspension of the gold standard on April 19th. American financial authorities are acutely aware¹ that "more currencies are now related to British currency than to the gold standard." As gold rose in value, and exchange quotations for sterling and its present associated currencies fell, the American farmer has been suffering from the tendency of wheat prices to decline. On the one hand, his selling agents had to contend with the fact that the sterling area ranks as a tremendously important group of consumers which has access to alternative suppliers in a world wheat market. On the other hand, these alternative sources of wheat have, in the cases of Australia and Canada, hitherto stood more within the sterling orbit than that of gold, while in the case of Argentina the American producer has to compete with a country which is a weak seller in a world of huge wheat carry-overs. United States farmers had—up to April 19th—to depress their wheat prices even further in order to jostle these competitors in the market. A similar thing happened to the prices American manufacturers of iron, steel, chemicals, and engineering products were forced to quote if they wished to maintain business with foreign customers. Their British rivals were able to under-quote them as gold appreciated and produced as a reaction a fall

¹ See *Monthly Review of the National City Bank of New York*, December, 1932.

in the sterling-dollar rate—a fall which could be aggravated by speculative action driving the rate down well below the normal purchasing power parity, and thereby unwittingly presenting the British producer with an export premium.

The definite suspension of the gold standard by the United States on April 19th undoubtedly eased the burden of competition in foreign markets for American farmers and manufacturers. As the exchange value of the dollar subsequently cheapened in gold and non-gold countries, American exporters would appear to have grounds for counting upon an increase in the prices received for their goods in terms of their own country's dollars. What in fact happened was that the United States Government had to make a political decision when faced with the choice of maintaining or raising the internal price level, or maintaining a gold standard exchange rate which brought constant pressure to bear in a downward direction on the prices of the country's products and manufactures. It was decided to put the people's price levels first.

Both Great Britain and the United States will recognize that there is no sempiternal profit in any competitive depreciation of currencies. Both have declared their earnestness in the reconstruction of stabilized monetary systems. Bearing in mind the huge stocks of monetary gold held in the United States, it is not to be expected that America will wilfully seek to prolong the confusion at present hampering international trade by constantly accelerating a depreciation in the dollar in order to raise

her dollar prices for exports, or even to give her traders a continuing export premium. On the threshold of a World Economic Conference, hopes cannot be too low that America also means to support a stabilized monetary standard.

With a Commonwealth gold sterling standard of the type outlined in Chapter V fully in being the United States should not find it difficult to arrive at some agreement governing gold movements between herself and the Commonwealth with its ancillary currency areas. Even if America cannot see her way to copy the new system, it appears more than likely that some less cohesive form of agreement between the two would be drawn up.

PRESTIGE OF THE LONDON FOREIGN EXCHANGE MARKET

When the Commonwealth project is brought into practical effect, propaganda against London as a short-term money market, in which foreign centres have already dabbled, must not be allowed to undermine the position of the sterling bill in world trade. The fullest publicity must be given to the details of the new methods, in order to familiarise overseas traders with the fact that the very last thing intended is an easy access to the path of wanton inflation on the part of this country and her associates. In particular, the independence of the Currency Board from politics must be stressed. It should not be forgotten that Holland, Belgium, the Dutch East Indies, and France all incurred

losses on their sterling balances at the time of the British suspension of the gold standard in 1931, and that memories of those losses may not be entirely unrelated to attempts which may be made to discredit the exchange standard, a monetary device which has in the past led to the employment of a number of countries' devisen balances in the London money market. One unhappy expression of this manœuvring was seen in the report from Basle in November 1932 that the experts entrusted with preparations for the World Economic Conference had arrived at the conclusion that the gold exchange standard system had been "badly conceived and badly organised, and must therefore be condemned." The judgment, so it was stated in substantially reliable newspapers, added that the gold exchange standard had engendered many abuses, had introduced disequilibrium into the world credit situation and must accordingly be abandoned. No official intimation has been issued that the British delegates agreed with this point of view, which carried with it the dogma that it is henceforward desirable to remodel monetary systems on a purely gold standard basis, and with the most reliable guarantees. One is entitled to hope and believe that the British Government delegates did not subscribe fully to these statements, which appear to have been reported somewhat enthusiastically by the Chairman of the Geneva experts, the Governor of the Bank of the Netherlands, to his fellow-directors on the Board of the Bank for International Settlements. Satisfaction must certainly be felt

over the fact that criticism in this form and with this degree of emphasis was not embodied in the experts' final version of the annotated agenda, which was issued in January, 1933. London should meet any opinion of the nature described by bringing prominently forward at the time of inaugurating the new system the fundamental element of safeguarded stability which underlies it. Such an action, backed by Britain's long period of close banking association with the majority of overseas countries, should not deter foreigners from maintaining in London the devisen balances which foreign centres so understandably covet. If, as these latter may well fear at the present time, London should eventually go on to some monetary standard different from their own gold systems, one can comprehend their haste to discredit in advance the potential British holders of foreign exchange balances.

SECURITY IN EVERY WAY

The present detached nature of many exchanges has led to a revival and extension of forward exchange dealings. Exporters and importers could still cover their transactions in this way should they find it difficult at first to grasp and accept the organisation of the new monetary system. If this is not clothed in unnecessary mystery, however, there should be little fear that merchants would still feel obliged to resort to forward exchange transactions to the present extent. The exchange market arranges the bulk of its forward business in terms of

periods up to three months, and purchases or sales for any longer period ahead, say five or six months, have to be settled by special negotiation. Not all traders who are anxious to combine an adequate measure of caution with a progressive selling of goods find these facilities adequate for their needs. To this extent, therefore, the forward exchange market of the present time is far from being an adequate alternative to normal spot market conditions, which traders are disposed to consider "sounder" because a greater degree of long-term control over the monetary standard is known to exist and is generally understood. The gold standard as practised in recent years, however, has finally arrived at the present chaos on the foreign exchanges. Whether its restoration in an almost unchanged form would instil new confidence into traders, and so lead to their holding more settled expectations regarding the course of exchange with their potential customer countries, is a highly questionable matter.

In view of the considerations previously set forth, expert opinion in countries whose currencies are now in the sterling area may hesitate a long time before seeing a returned set of virtues in the gold standard as it is understood to-day in many quarters in the United States and a number of European central banking parlours. The case against too simple a faith in the old ways stands overwhelmingly strong, whether in terms of statistics, theory or social needs. A reformed "gold" monetary structure along the lines described in this volume would

offer that settled expectation regarding the course of exchange rates which importers and exporters desire when entering into their commitments. In itself it would at once lead to an expansion of foreign trade, since merchants would feel that greater security existed at the least over the whole area covered by the arrangements. More willingness to shoulder normal mercantile risks would become evident, and the resultant flow of orders would provide work for idle hands in the industries of this country. Forward covering, however, would always be available to merchants whenever they viewed with suspicion the possibility of a continued downward trend of wholesale price levels in the "pure gold" states abroad. But it should be noted that any disturbance of the exchange rate on the countries concerned would not arise from a weakness in the sterling system, but from the inherent defects of the allegedly adequate "pure gold" standard.

Political realities could thus be blended with the judicial-economic concept of currency control in the revised form of gold standard outlined in the foregoing pages. In particular, the point of view of the British Commonwealth countries would be accorded full recognition. Commonwealth criticism, which has already been heard with regard to the obscurities of the present monetary policy in Great Britain, would be met by the overseas countries' majority in voting power on the Currency Board. No fear need then exist "that propaganda ¹ for new mone-

¹ *Financial Post*, Toronto; leading article, June 25th, 1932.

tary notions is being done, consciously or not, in the interests of an international banking group in London." This particular opinion, which was printed in a leading Canadian financial paper, added that "this banking group requires only a sufficiently wide acceptance of managed currencies under the Bank of England to dominate the world." The system proposed would involve no subservience on the part of any country, including Canada, nor would it lead to the foisting of an unwanted central reserve bank on that country. As a supreme Commonwealth and international objective, equality of status in co-operation for monetary stability is effectively provided.

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