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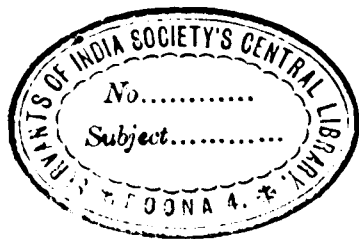


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# **MONEY AND THE MACHINE AGE**

# MONEY AND THE MACHINE AGE

BY  
T. W. WYATT



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## INTRODUCTION

THE problem of production has been solved, and our ability to produce is still constantly and rapidly increasing. These are the facts which have upset and will upset a great many of the ideas on which our present system of society is based. A monetary system is bound to be of great importance in a state of society in which people cannot live without the use of money. It is, therefore, of great importance that the monetary system should be properly adapted to the needs of the whole system which it serves. Otherwise we are sure to suffer from chronic financial disorders and alternate booms and slumps.

The following is extracted from the speech of the Chairman of the Dunlop Rubber Company (Sir Eric Geddes) given at the Thirty-first Ordinary General Meeting of the Company on May 9, 1930, and is only one instance of the progress that is being made in increasing productive capacity and productive efficiency. At subsequent Annual Meetings it has been stated that further progress has been made. Similar progress has been and is being made throughout the world.

### PRODUCTION AND EFFICIENCY

“I have from time to time referred to the improvement in the efficiency of your factories. It is a feature on which we pride ourselves and which is commented upon most

favourably by the many visitors who, during the course of the year, pass through the works. This improved efficiency does not only obtain at Fort Dunlop but obtains in all your other factories without exception, and I can say definitely that it has been of inestimable value in enabling us to maintain the position of the company at home and abroad.

"The output per worker at our various factories at home and abroad is about two-and-a-half times what it was five years ago.

"This improvement has not been brought about by what could be called 'driving methods.' Far from it; it has been brought about by improvement in process and machinery, improved lay-out, more regular flow of raw material and semi-finished material to the workers, while at the same time, without exception, the workers have given of their best. This improvement in output has had a marked effect on costs, and I am glad to say that we are in the position of being able to show lower costs of production, with, at the same time, increased earnings for our operatives."

We live in an age of unbounded possibilities. The tremendous advance in man's power over nature during the past twenty to twenty-five years has brought an infinitely higher standard of life than ever before within our grasp. Instead, however, of this advance being a blessing it has caused great suffering and a world-wide depression. Why is this? And why should we have great poverty in the midst of plenty? Obviously many of our current ideas must be wrong if their application produces such absurd anomalies. The object of this book is to endeavour to correct these ideas and so enable us to take advantage of the benefits of our new knowledge.



The present system of society is called Capitalism, that is, a state of society in which most of the means of production are privately owned ; the motive force is private profit ; the exchange of goods and services are effected by money payments ; and assets, liabilities and profits are measured in terms of money. A much higher standard of living than the present standard is possible within the existing Capitalistic system. Whether, with the advent of improved leisure, better general nourishment, and better education, a rise in the level of intelligence of the community will enable another system to take the place of Capitalism, remains to be seen. It is outside the scope of this book to discuss that question. There is no doubt, however, that we are on the eve of great changes, for the forces that have been released are of immense power, for good or evil. If we can learn to think clearly and logically and to place personal prejudices on one side, the new world which will be opened to us will be far finer than humanity has yet experienced. Are we going forward or backward ?

This book is in no way an attack on the Bankers, they are among the most conservative of men, but this is not surprising as this quality has stood them in good stead in their business life. If the rest of the community demands it, they will adapt themselves to the new conditions which the Machine Age makes necessary. The Banks are an extremely important part of the Business Machine, and without them the Machine Age and its unbounded possibilities for good would not be possible. They are in fact a part of the machinery of the Machine Age.

## CHAPTER I

### THE TRADE CYCLE—THE WAR AND UNEMPLOYMENT—MONEY AND PRICES— THE ECONOMY CAMPAIGN

PRIOR to the War unemployment rose and fell at fairly regular intervals ; even then occasional big rises took place, but there was sufficient regularity about the rises and falls to justify the name of trade cycles being given to the phenomenon of the recurrent booms and slumps of trade.

These were regarded with a certain amount of complacency, for even if trade was bad, this had happened before and eventually good trade had returned. Very little effort was made to discover the root causes of the trade cycle ; in fact, the conventional idea was that trade cycles were inevitable and, instead of looking for the cause, bad trade was said to be due to the trade cycle itself.

With the advent of War unemployment disappeared, and was unknown until the men returned again to civilian life. The experts then told us that, since the War had caused so much destruction of material wealth, we should all have to work harder for less wages in order to make up for this great destruction. The astonishing fact was that on returning to civilian life men found it very difficult indeed to get the oppor-

tunity to do their share of re-creating the lost wealth, and, except for the short-lived boom just after the War, we have had at least two million unemployed ever since, rising at times to three million. Why, if it is necessary to re-create destroyed wealth, are men and women denied the opportunity of doing so? Machinery might be blamed if everybody had sufficient of everything to make life comfortable and happy, but this is notoriously not the case; we are obviously refusing to let machinery produce the things so badly needed. We were told we were short of money and that as we had borrowed so much we must economise in order to repay our debts. Accordingly a great economy campaign was inaugurated; in fact, we have had at least two such campaigns since the War. Both utterly failed to achieve their object and relief was obtained from quite a different source, as will be demonstrated later. Were we really short of money after the War? On page 3 are the figures as given in the *Banker's Magazine* of August 1935.

The figures can hardly be said to indicate a shortage of money! Just the reverse. Why then was the statement made?

During the War the Gold Standard was suspended and money was printed by the Government as it was required, the banks used this money as the basis for the creation of Bank Credit which really makes up nine-tenths of all bank deposits. (See chapter on the Gold Standard.) The National Debt had also enormously increased from about £600 million pre-War to about £8,000 million in 1920. Bankers, who are almost always the most conservative of men,

**BANKS IN THE UNITED KINGDOM**

*Totals of Cash in Hand, at Call and at Short Notice (Col. I).  
Specie held at Bank of England (Col. II): Total of Deposits,  
Current Accounts and Note Circulation (Col. III)—Years  
1905-34*

Year.	United Kingdom.		Col. III. Deposits, Current Accounts and Note Circulation.
	Col. I. Cash in Hand, at Call and Short Notice.	Col. II. Gold held at Bank of England (included in Col. I).	
	£	£	£
1905	253,000,000	29,000,000	925,000,000
1906	262,000,000	34,000,000	955,000,000
1907	264,000,000	38,000,000	958,000,000
1908	274,000,000	31,000,000	989,000,000
1909	290,000,000	37,000,000	1,002,000,000
1910	279,000,000	31,000,000	1,043,000,000
1911	299,000,000	32,000,000	1,079,000,000
1912	305,000,000	31,000,000	1,129,000,000
1913	342,000,000	43,000,000	1,172,000,000
1914	413,000,000	68,000,000	1,367,000,000
1915	384,000,000	51,000,000	1,505,000,000
1916	510,000,000	54,000,000	1,714,000,000
1917	603,000,000	59,000,000	2,015,000,000
1918	692,000,000	79,000,000	2,400,000,000
1919	689,000,000	91,000,000	2,845,000,000
1920	719,000,000	128,000,000	3,019,000,000
1921	702,000,000	128,000,000	2,970,000,000
1922	661,000,000	127,000,000	2,800,000,000
1923	649,000,000	128,000,000	2,723,000,000
1924	677,000,000	129,000,000	2,815,000,000
1925	692,000,000	145,000,000	2,803,000,000
1926	701,000,000	151,000,000	2,815,000,000
1927	755,000,000	152,000,000	2,867,000,000
1928	775,000,000	154,000,000	3,194,000,000
1929	753,000,000	146,000,000	3,144,000,000
1930	749,000,000	148,000,000	3,276,000,000
1931	654,000,000	121,000,000	3,073,000,000
1932	698,000,000	120,000,000	3,353,000,000
1933	759,500,000	191,000,000	3,347,000,000
1934	801,000,000	192,000,000	3,374,000,000

Note increase in all items from 1915 to 1918 and further increase in 1919 and 1920.

were very concerned about the position, although they had made far larger profits than ever before in the period of inflation during and just after the War. They were anxious to get back to the Gold Standard, and the Government under their pressure appointed a Royal Commission with a one-time Governor of the Bank of England, Lord Cunliffe, as Chairman. This committee recommended that we should return to the Gold Standard at the pre-War parity as soon as possible.

It is true that the increase in the amount of money was due to the policy of inflation pursued during and after the war and that prices had risen very considerably. Wages and profits had also risen and, although deposits were higher, the pound had a much lower purchasing capacity. The reason for this was that our men and women and machinery had been producing guns, and shells, battleships and fighting aeroplanes and uniforms, etc. ; other things were scarce and therefore dear. If all that effort and ingenuity had been used in the production of food, clothing and houses, etc., these things would have been plentiful, we should have had an abundance of everything and prices would have fallen and not risen, and practically everybody would have been much better off. One other effect of our devoting our energies to the War was that we had almost ceased to sell goods abroad and had bought large quantities of goods from the U.S.A. and various neutral countries. This caused a demand for the currencies of these countries which forced up their values in terms of pounds so that in the case of U.S.A., for instance, as against a pre-

War exchange of  $\pounds 1 = \$4.88$ , after the War the rate dropped to about  $\pounds 1 = \$3.30$ , in newspaper language,  $\pounds 1$  was only worth about 13s. This is a very misleading way of expressing it, but it conveys a good idea of the extent of the depreciation in the purchasing power of the pound.

Prices in England had also risen in greater proportion than in U.S.A. and various neutral countries, as we had devoted a larger proportion of our energies to the War, and a smaller proportion to producing the things required in peace, so as explained above, the prices of these things had risen. If, therefore, we were to resume our place as the largest exporting nation in the world it was essential that either we should devalue the pound to equalise our costs with those abroad, or that we should lower our costs and prices in terms of our own money.

For instance if in U.S.A. an importer wished to buy 100 items of English goods he would of course first ask the price. If the English exporter quoted  $\pounds 1$  each, the U.S.A. buyer would be required to pay 488 dollars if the rate was 4.88, but only 330 dollars if the rate was 3.30. It is obvious that the U.S.A. buyer might find it worth his while to buy for \$330 but not for \$488, and if we pushed up the rate to \$4.88 we should either lose the trade or be compelled to lower our prices as expressed in pounds.

We could have lowered our prices eventually if our men and women and machines had been given time to change over from war production to peace production, but the Cunliffe Committee recommended that the pound should be restored to its pre-War parity at

## 6 MONEY AND THE MACHINE AGE

the earliest possible opportunity. That is, we should return to the Gold Standard at the pre-War price of gold. This meant they rejected devaluation of the pound which has since been forced on us, and decided on a policy of *Deflation*. In newspaper language "the pound was to be enabled to look the dollar in the face."

The Government accepted the report of the Cunliffe Committee and proceeded to put it into force. Seldom has a decision had more calamitous results. The amount of human misery and suffering it has caused has been colossal and in the end the policy utterly failed to achieve its object of avoiding devaluation of the pound. It would have been far easier for us to have devalued the pound and thus not only should we have brought our internal prices into relation with external prices and made the prices of our exports attractive to foreign purchasers, we should also have avoided the necessity of an attack upon wages and salaries. The relation between debtor and creditors which had grown up during and after the War would not have been again violently upset and the real amount of our National Debt would not have been as violently increased.

Prices of commodities would not have been drastically reduced by the dual effect of a reduction of purchasing power, and the increase of supplies caused by the cessation of war demand and the re-entry into production of the army which had been devoted to destruction. Prices would merely have fallen steadily and this would have caused no harm to producers as they would have been able to sell larger

quantities as more purchasing capacity would have been available due to the war inflation.

That the above view is correct is shown by our experience when we eventually devalued in 1931. It is interesting to observe that the same forces which were against us, also acted against the U.S.A. later on, after we had been compelled to devalue the pound, and after causing the greatest slump ever heard of, the U.S.A. were also compelled to devalue their currency. An extract from *The Times* of May 20, 1936, is here given regarding the experience of Belgium :

### A NEW DEAL IN BELGIUM

#### THE ATTITUDE TO FRANCE

##### I.—GOLD AND THE FRANC

##### *From our Special Correspondent*

The economic crisis in Belgium is over, and the country has again emerged from the shadow of depression. By boldly putting an end to the relentless deflation pursued by previous Governments M. van Zeeland, the Prime Minister, has restored profits to industry, revived confidence, and found jobs for thousands of idle hands. . . .

So marked are the changes that have been wrought in Belgium since April 1935 that it is hard to recall the extraordinary circumstances under which M. van Zeeland took office as head of a National Government supported by the Catholic, Liberal, and Socialist Parties. At that time the country was in the grip of a major financial and economic crisis. The efforts of previous Governments to depress the level of Belgian gold prices down to the level of sterling prices had so slowed down the *tempo* of commercial activity that business life was almost in a state of suspended animation. After six years of uninterrupted deflation Belgian prices were still far above world prices. The chief exporting industries, which had to sell their



products at the world level, were making heavy losses. Nearly half of all the limited companies registered in Belgium were "in the red" in 1934. Budget receipts were shrinking so rapidly that there seemed no limit to the deficit which would ensue. And unemployment had grown to such a level that State expenditure on relief could not have been met without a heavy increase in taxation. The effects of unemployment on internal trade were disastrous; it is estimated that the purchasing power of the working classes as a whole was one-fifth lower in 1934 than in 1929, in spite of the decline in the cost of living which had taken place in the meantime.

The absence of industrial profits had serious effects on the country's banking structure, which was heavily engaged—some say too heavily—in industrial financing. First a trickle, then a stream of deposits poured out of the banks to be hoarded in the form of gold and foreign exchange. Foreign deposits also were withdrawn, and between January 1934, and March 1935, the National Bank lost about 5,000,000,000f. in gold. When M. van Zeeland came into power devaluation had become inevitable for the second time in a decade. True, the technical position of the National Bank was still so strong that a further heavy efflux of gold could have been faced with equanimity. But six years of deflation had so exhausted the country that any further cut in costs and wages, either by Governmental or monetary pressure, was virtually impossible. In effect, therefore, Belgium was pushed off the gold standard. It became M. van Zeeland's first task to prevent the retreat from gold from turning into a rout. His second was to lay the foundations of a new prosperity on the ruins of the old. He has done both. An enthusiastic Chamber on April 8, 1936, unanimously approved the policy pursued by the Government during its year of office.

#### A PORT OF REFUGE

On March 31, 1935, the Government set the depreciation of the franc at 28 per cent. and established an Exchange

Equalisation Fund of 1,125,000,000f.—derived from the revaluation of the country's gold reserves—as a first line of defence for the currency. But the spread of confidence was so quick that the Fund was not called upon to intervene. By June 20 the gold reserves of the National Bank had grown by about 7,000,000,000f., and Brussels had become a port of refuge for French and Dutch capitalists. So strong, indeed, was the position only a few months after the March panic that Belgian financiers were able to resume foreign lending; to the French State Railways, among other borrowers, they advanced 600,000,000f. This and similar operations had no effect on the stability of the franc, which, in practice, remained on the gold standard, though at a new level, and on March 31 of this year the Government found it possible to legalise the union between the gold standard and the new franc.

It is probable that M. van Zeeland would have preferred to attach the Belgian currency to the sterling standard. His closest advisers, who, like himself, are young men, and who have been much impressed by the economic recovery in Great Britain and Sweden, were convinced of the advantages to be derived from association with the sterling area. They pointed out that sterling now had a greater influence on the course of world prices than gold, and that attachment to the sterling standard would have given greater scope for the reflationary policy which it is the aim of M. van Zeeland to pursue. But the National Bank preferred gold because it feared that the maintenance of a managed currency might have endangered the position of Brussels as an international banking centre. Moreover, it was felt that the 5,000,000,000f. which had fled the country would not have returned if the holders had not had the assurance of getting gold at will.

So long as there is no further fall in gold prices the present exchange rate and the present level of Belgian prices give ample scope for the Government's reflationary policy, which has already had the effect of reducing the official unemployment figure by 40 per cent. since March

1935, restoring the buoyancy of the national revenue, and raising the status of Government credit to the highest level attained since the War. Under the active encouragement of the authorities wholesale prices during the year have risen by 24.5 per cent. This has restored the profit-margin of industry, particularly of the export industries. It is true that retail prices have risen at the same time and that a rise in the cost of living is finding its way into the homes of the people. But the Government has kept a careful check on the movement, particularly for the first three months after the devaluation, when the public showed a tendency to make "panic purchases," and the rise since March 1935, is only 9.2 per cent. of which 6.5 per cent. has been estimated as being due directly to the devaluation. The wide gap between wholesale and retail prices has thus been narrowed, and the price structure is now in equilibrium. Moreover, at the present level of retail prices the purchasing power of the franc is still higher than in 1933, and the cost of living in Belgium is probably lower than anywhere else in Western Europe.

#### SIGNS OF PROSPERITY

Under the influence of these invigorating price movements the drooping spirits of the economic organism rapidly revived. Retail trade moved up with a jerk, and with it the proceeds of the turnover tax, which had fallen practically without interruption during the years of deflation. In March 1936, they were about 25 per cent. higher than in March 1935. For the first three months of the devaluation, as has already been pointed out, some of the advance was no doubt artificial. But as unemployment diminished and the purchasing power of the working classes grew, and as agricultural prices advanced and farming again became more profitable, the momentum of recovery was maintained. The reorganization of the money market and the reduction of the long-term rate of interest following upon the Government's successful conversion operation facilitated a resumption of building activity. Internal

demand was further stimulated by public works and Government orders, whose volume was increased beyond the level usually set by the Extraordinary Budgets. At the end of 1935 the index of industrial production was some 20 per cent. higher than at the end of 1934.

Exports have slightly increased, but most of the revival is based on the home market. Imports, on the other hand, rapidly advanced, due to the better demand for raw materials, with the result that the unfavourable balance of trade, in paper francs, is now higher than at any time since 1930. But so great has been the increase in tourist traffic, owing to the devaluation and to the Brussels Exhibition, that the balance of payments shows a satisfactory credit.

## CHAPTER II

### DEFLATION AND DEVALUATION

WHEN deflation is decided on the procedure is as follows :

The Bank Rate is raised.

The Bank of England sells Government securities and when the proceeds are received it withdraws them from circulation. This reduces the cash in hand of the banks and compels them to reduce lendings and sometimes sell investments in order that their deposits shall not be more than ten times their cash holdings. (See chapter on the Gold Standard.) In other words the withdrawal by the Bank of England of cash from the banks compels them to reduce their deposits by ten times as much as the cash withdrawn. The above sales by the banks depresses the price of Government securities as also does the raising of Bank Rate, both have the effect of causing the prices of practically all securities to fall, including that of freehold land and house property. The drop in the prices of securities lowers the reserves of individuals and companies. If either are in need of money they must sell on an unwilling market and, therefore, obtain a poor price, or if they try to borrow they find the banks will only advance a much smaller sum against their securities in view of their lower value, and interest rates are

high owing to a high Bank Rate. The net effect is that enterprise and development is checked and spending generally is restricted. The restriction of spending inevitably causes unemployment and reduction in profits, which again restricts spending of those unemployed and those in fear of it, also those whose dividends are reduced.

The restriction of lendings by the banks compels sales of commodities which have been financed by borrowed money. Prices of commodities are thus forced down. The market for commodities is also restricted by the restriction of spending mentioned above. The lower price of commodities causes many bankruptcies and losses to farmers and manufacturers. They are compelled to economise and to restrict production, if they can, and to discharge employees. Following as a result of the above shopkeepers report bad trade and profits are lowered everywhere. Then the Government feels the pinch. Owing to a high Bank Rate the cost of Government borrowing increases and in these days of a huge Government debt this is a very serious matter, if it is considered necessary to balance the Budget.

The cost of maintaining the unemployed is increased. To make matters worse revenue falls due to :

Lower incomes.

Lower profits.

Lower yield on Stamp Duties, etc.

Lower Revenue and higher expenditure means an unbalanced budget which involves higher taxation and again reduced spending and more unemployment. The banks also soon find themselves with a number of

frozen advances which naturally makes them more exacting in their requirements regarding loans. Our financial system is like an inverted pyramid, the whole structure whilst we are on a Gold Standard is based on a small amount of gold and the removal or addition of a small quantity has a quite disproportionate effect on the mass of credit piled above it. Now that we are on a modified form of Gold Standard, how much modified it is not yet possible to say, the effect of a loss of gold can be nullified. If, however, the authorities desire to pursue a policy of deflation they can still do so. The base of the inverted pyramid is now composed of the cash in the hands of the banks, and the amount of this cash is determined by the Treasury and the Bank of England. An increase or decrease in the amount of this cash has a similar snowball effect to that exercised by the addition or removal of gold whilst we were on a Gold Standard. The result of a deflation policy in the U.S.A. was almost complete collapse. Banks failed on all sides and unemployment rose to colossal figures. The Government was compelled to close all the banks that remained open and to devalue the dollar. This caused a rise in commodity prices, and also provided the Government with large credits. The rise in commodity prices directly assisted all holders and producers of commodities such as farmers, merchants, shopkeepers and all owners of ordinary shares in companies which have to carry large stocks of goods. The banks were much benefited, as the loans they had made to the above owners and producers of commodities were now much better secured. The revaluation of the huge gold stock of

the U.S.A. at the increased price of gold put a very large credit at the disposal of the U.S.A. Government and the new valuation of the total gold formed a much larger basis on which to build additional credit. So that by the devaluation of the dollar the Government of the U.S.A. were able to assist the banks to reopen, to obtain credits to assist industry, and owing to the rise in commodity prices to give new hope to producers of commodities. Retail prices did not rise in anything like the same proportion as wholesale prices. The reason is given elsewhere in this book. The rise in commodity prices was due, firstly, because after devaluation of the dollar those commodities which have a world market such as cotton, wheat, oil, copper, were quoted in depreciated dollars. Before devaluation the dollar rate was  $\$3.30 = \text{£}1$ ; after devaluation the rate rose to over  $\$5 = \text{£}1$ . The equivalent price of copper quoted in England at  $\text{£}30$  per ton with the dollar at 3.30 was  $\$99$ ; whilst with the dollar at 5 to  $\text{£}1$ , the price per ton would be  $\$150$  per ton. In actual practice the full rise in prices does not take place as the rise tempts sales by holders of commodities and this checks the rise. If then the price of copper rose to  $\$120$  per ton with exchange at  $\$5 = \text{£}1$ , the price in England would be compelled to fall to  $\text{£}24$  per ton. So that a depreciated currency in one country tends to make prices fall in other countries with a stable currency. The suspension of the Gold Standard by England caused prices to fall in U.S.A. and contributed largely to the collapse there and to their eventual devaluation of the dollar.

The devaluation of the dollar in U.S.A. was effected



in a different way to the method adopted by us when we suspended the Gold Standard. We merely suspended the law under which the Bank of England was compelled to sell gold at a fixed price of equivalent to 85s. per fine ounce. A free market is allowed in gold and no restrictions are placed on its import or export. But as gold cannot be obtained at the old price from the Bank of England anybody who requires gold for export or hoarding, etc., is compelled to purchase in the open market. Consequently, the price of gold in England tends to equal the price at which gold can be bought in other countries. When the U.S.A. devalued the dollar the President of the U.S. was given power to devalue the dollar up to 50 per cent. ; he did in fact devalue by 40 per cent., and increased the price of gold to \$35 per ounce. The rate of exchange between U.S.A. and Great Britain, apart from intervention by the Exchange Equalisation Funds of either country, and now that we are not on the old Gold Standard, rises and falls as demand and supply fluctuates ; if the rate of dollars to £1 is 5 the price of gold in London is £7 per ounce, as the price of gold in U.S.A. is \$35 per ounce, plus or minus the cost of transporting gold from one country to the other. If the buyers of gold in London wish to keep the metal in England they will be prepared to pay a premium in London over the price they would have to pay in U.S.A., as if they bought in U.S.A. they would have to pay the cost of transporting the gold to London. There has been a big demand for gold on the London market and the price per ounce has usually been above that which would be obtained by dividing the price of gold in

U.S.A. by the pound-dollar rate. Similar conditions prevail as regards France. The price of gold in London has usually been above the price at which gold could be bought in France if francs had first been bought with pounds at the current rate and the francs then used to buy gold in France.

In Great Britain unemployment pay (or the so-called Dole) acted as a reserve of purchasing power and we were able to avoid the almost complete collapse experienced in U.S.A., although we suffered extremely severely.

One other serious effect of deflation is that all debts are increased in real value and become an ever increasing burden as incomes are lowered and assets depreciated as a result of deflation. The real amount of the National Debt was enormously increased as a result of the deflation policy during 1921, 1922 and 1923, and far outweighed any relief caused by repayment of part of the debt.

One of the ironies of the situation caused by deflation is that it is usually said the trouble is due to a lack of confidence owing to an unbalanced budget, after the budget has been unbalanced by deflation. The remedy then suggested is always more economy and taxation in order to balance the budget, with the inevitable result of more depression and more unemployment and again an unbalanced budget. This situation has never been cured by deflation. When trade has improved it has always been due to some factor which has released the pressure of deflation, such as our compulsory departure from the Gold Standard in 1931 and the subsequent devaluation of the pound

or, as mentioned in previous pages, the devaluation of the dollar in U.S.A. Deflation and devaluation have similar results in whatever country they are tried. Japan's prosperity dates from the deliberate devaluation of the yen and many other instances could be given.

The distress in many parts of Japan is not due to devaluation, but is mainly due to the very high proportion of the income of the country which is absorbed by their Army, Navy and Air Force.

Trade depression and unbalanced budgets are in full swing in France, Holland and Switzerland and their only hope of recovery is devaluation of their currencies, unless a war or a substantial increase in the production of gold causes a rise in prices in other countries and so relieves the pressure on them.

Since writing the above France, Holland and Switzerland have been compelled to devalue. They have each benefited and Holland and Switzerland should soon experience a return to prosperity. It is doubtful, however, if France has allowed her currency to depreciate to a sufficient extent, 125 francs to the pound would have been a much more satisfactory parity. The French Government also made a very bad mistake when they tried to penalise those of their citizens who had purchased gold in order to avoid the depreciation of the franc. It would have been far wiser to have adopted the same measures as we did in 1931. To have maintained a free gold market and instituted an Exchange Equalisation Fund to prevent undue depreciation in their currency. France will not experience the full benefits of devaluation until she has brought

the internal value of her currency into line with its international purchasing power.

It is of course true that unrestricted inflation, as occurred in Germany, would do a very great deal of harm, but nobody suggests that such a policy is necessary or desirable. The alternative to a policy of drastic deflation is not drastic inflation. There is a sensible medium between the two.

One important point to remember is that the Government and the Bank of England between them have the power by means of their control over the amount of cash held by the banks, to determine the amount of deposits in the banks. The same power has an extremely important influence on the level of commodity prices.

As a result of the sacrifices during the period 1921 to 1925 the pound was again able to look the dollar in the face, and was again quoted at the pre-War rate of about \$4.88. The orthodox idea was that as we had achieved this great victory all that was now necessary was to await the return of prosperity. For it must not be forgotten that those in charge of our financial machine were convinced that on moral and material grounds it was incumbent upon us to restore the pound to its pre-War parity. They were convinced that only by this method could we regain our pre-War position as the centre of world finance and also regain our foreign trade. Many a general and admiral have been utterly disgraced for making far less serious mistakes, but it is essential to remember the decisions were made in entire good faith.

Our financial advisers totally failed to realise that

an industrial revolution which was gathering force before the War had received an immense impetus by the needs of the War, and that productive capacity had increased to such an amazing extent that only by a very great increase in the standard of living could work be found for all willing and anxious to do so. By no other means can the new productive forces be utilised except we are prepared to maintain either a great Navy, Army and Air Force, or an immense army of unemployed.

It must not be forgotten that the depression through which we have been passing has delayed the development of new methods of production and any sustained improvement in trade will again encourage development with the result that our present standard of production will easily be attained by a far smaller labour force.

In other respects our financial advisers were at fault as will be seen in the account of the financial transactions after we returned to the Gold Standard.

## CHAPTER III

### OUR RETURN TO THE GOLD STANDARD

AFTER great sacrifices as a result of which some of our industrial areas were likened to the devastated areas of France and Belgium the pound was again forced up to its pre-War parity with the dollar and, according to the orthodox, the first stage of the battle to recover our pre-War financial supremacy had been won. Let us compare our position before Gold Standard and after Gold Standard.

One of the reasons given for our returning to the Gold Standard was that it would be easier for us to repay the very large amount we had borrowed from U.S.A. in order to finance our allies in the Great War. Another reason given was that we had lent and invested large sums abroad, and if we depreciated our currency our foreign debtors would gain an unfair advantage at our expense. Both reasons, although plausible, were fallacious.

As regards our debt to the U.S.A. it certainly seemed at first sight that as a pound was now worth more dollars and as we had now to provide in our budget for a much smaller number of pounds to meet the annual charge in dollars, that we had done a fine stroke of financial business. But we had to sell goods and services to U.S.A. before we could obtain dollars

there unless we were prepared to send gold, and the effect of the rise in the rate of exchange was to make our goods very much more expensive in terms of dollars and other foreign currencies. The rise also had the effect of making foreign goods cheap to us in terms of pounds, so that whilst the return of the pound to pre-War parity encouraged us to buy abroad it made sales abroad much more difficult. Let us take as examples coal and motor-cars.

If British coal was quoted at 100 francs a ton in France before our return to pre-War parity the price after return was 150 francs, so that if we were to maintain our sales of coal our prices in pounds had to be drastically reduced. To do this the coal owners enforced big reductions in wages, and the coal lock-out and the disastrous general strike which followed was a direct consequence of the return of the pound to pre-War parity. As regards motor-cars, our trade, which had shown signs of recovering the position it had lost owing to the War, received a severe set-back. American motor-cars became cheaper as dollars became cheaper, whilst our cars were dear abroad as pounds had risen in value, consequently sales of American cars in this country rapidly increased, whilst we found it almost impossible to sell our cars abroad.

It is interesting to see, when we were compelled to devalue the pound in 1931, that sales of American motor-cars in this country almost ceased, and sales of our cars abroad greatly increased as dollars were then so much dearer, but when the dollar was devalued, the sales of American cars here and abroad increased rapidly.

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A similar case of inability to see beyond the first plausible argument presented, is the case of Chinese currency. It was argued that if the price of silver was raised it would increase the purchasing power of the Chinese and so make it possible for them to buy more from Europe and U.S.A. The silver purchase policy of U.S.A. soon demonstrated, however, how absurd was this reasoning. The increase in the price of silver caused a corresponding rise in the price of Chinese goods as expressed in foreign currencies, this rise in price caused a big decrease in foreign purchases of Chinese goods and a big drop in the foreign currency available for purchases of foreign goods by China.

The endeavour to lower Chinese prices to enable sales to be made abroad caused much distress in China, and the export of silver due to its rise in price as expressed in foreign currencies finally compelled China to break with a tradition of silver as currency which was far more firmly established than the Gold Standard was with us.

To return to our own position after the return of the pound to pre-War parity, as already demonstrated this had raised the prices of all our exports in terms of foreign currencies. To sell abroad we must buy abroad. To be able to buy abroad we must sell abroad.

To sell abroad we must, therefore, reduce our selling prices. This meant lower wages, and lower profits, and for the Government lower revenue from taxation. Lower wages and lower profits meant lower purchasing power, consequently lower prices for commodities. Our creditors abroad had now to send us more goods if they were to realise as many pounds, as prices here



had fallen, but found our market was unable to buy as the purchasing power of our consumers was lower. The prices quoted for Foreign Government Stocks and Argentine Railway Stocks bears eloquent testimony to the absurdity of our policy of pushing up the value of the pound. To assist us to reach and maintain the pre-War parity an embargo was laid on foreign lending, this only made and makes matters worse, for except in certain instances where advantage is taken of the facilities of the London money market to borrow in order to purchase in other countries, money borrowed here must be spent here. In fact, no money is actually exported and the loan raised goes out as exports of British goods. This embargo was the main reason for the drop in our exports of manufactured goods, to countries which sell raw materials to us, and caused a big rise in the apparent adverse Balance of Trade (see Chapter IX).

In fact, there is very little prospect indeed of these raw-material producing countries ever being able to repay the loans they have raised here and they cannot maintain the interest unless we are prepared to continue lending to them. They could only repay us if we were engaged in war and our own productive capacity was absorbed in war production. Our investments abroad would then constitute a very valuable war reserve.

One other very important result of the restoration of the pre-War parity of the pound was an enormous increase in the real value of our National Debt and of all internal debts.

Debts still remained the same in money, although

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incomes and prices were being forced down. Interest on the National Debt and all other debts became a much larger proportion of income than before. Rent and interest that were reasonable at a higher income level became burdensome and almost intolerable with a lower income. As prices of assets fell so the margin over debts decreased.

Our National Debt of £8,000 million represented about 1,280 million ounces of gold in 1920, but 1,880 million ounces in 1925, its value in wheat, coal, etc., had risen in even greater proportion—about 65%.

The fixed charges for debts and rents is the main reason for the increased spread between retail and wholesale prices which is always so evident during times of deflation, and also the main reason why it is so difficult to force wages down, as a very large proportion of all wages and retail prices is made up of rent and interest.

The effect of our return to pre-War parity in 1925 was disastrous, but its real effect was hidden for a time by a tremendous outburst of foreign lending by the U.S.A., which had enormously increased its holding of gold as a result of the War and had increased its bank credit accordingly. This increased credit stimulated internal trade, and foreign lending increased its foreign trade, both increased internal profits and started the greatest Stock Exchange boom ever known.

The enormous foreign lendings tended to counteract the effect of deflation here and trade improved steadily from 1927 to 1929, which was a comparatively prosperous year, but when the financial authorities in U.S.A. became alarmed by the speculative fever and started

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deflation, foreign lending ceased and the collapse started. To the effect of deflation on prices was added the effect of the new powers of production. Can it be wondered at that the system almost collapsed in U.S.A. and that depression was world-wide ?

## CHAPTER IV

### THE COLLAPSE OF THE GOLD STANDARD

WITH the return to pre-War parity our authorities decided, obviously with the support of U.S.A., to reduce Bank Rate and cheapen credit generally, but they reckoned without an entirely new factor. France was found to have an enormous amount of money deposited in London and as our Bank Rate was lowered the interest allowed on her deposits was lowered and she proceeded to withdraw her deposits in the only way possible, unless she was prepared to take our goods in settlement and this she certainly was not. She, therefore, took gold and was of course only able to do so because we had returned to a Gold Standard. If we had not so returned she would have been compelled to purchase francs or foreign currencies with her pounds and this would have depreciated the value of her pounds, and acted as a deterrent to her action, but as we had presented her with a magnificent opportunity she naturally took advantage of it and thus began the steady flow of gold to France which was such a mystery to our financial experts at the time. It was this drain of gold from us to France which was the final deciding factor in compelling us to abandon the Gold Standard in September 1931. How was it that France obtained such huge deposits in London ?

Were our authorities aware of it and if so why did they return to a Gold Standard in spite of it ?

The reason why France became possessed of these huge deposits is simple. We and U.S.A. presented them to her via Germany. So that it was our own policy which enabled France to defeat our endeavour to remain on the Gold Standard. The position we had won at such great cost was thrown away by our own action.

When the Great War was over it was decided that Germany should pay a huge indemnity. It was obvious she could not pay in gold, so we took her mercantile fleet and all her navy, and compelled her to send goods of all kinds without payment to our allies in settlement of reparations. This soon brought us to our senses. Free coal to our allies ruined our coal trade. Free ships to us ruined our shipbuilding industry. Free German manufactures would soon have stopped all our export trade in manufactures, so we called a halt. But surely it was argued it was only fair that the enormous damage done in Northern France should be repaired and paid for by Germany. Naturally also French men and women demanded that French men and women should be employed in restoring the devastated area. It was unthinkable that foreigners should have work whilst Frenchmen were unemployed. In what way, however, was Germany to obtain the money to pay French men or women to restore the area ? German goods were not wanted if they competed with French goods. A deadlock ensued. Consequently France invaded the Ruhr but still could not obtain the money. Eventually the Dawes plan was

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evolved and under this Great Britain and U.S.A. agreed to lend Germany a large sum of money and with this money and other large sums advanced to Germany by us and America, Germany paid reparations to France.

But France was still determined that her devastated areas should be restored by French men and women, and they of course required payment in francs. The French Government made the payments in francs, obtained by printing the notes and by the creation of Bank Credit, that is in much the same way that similar payments are made in practically all other modern countries. These payments were to French people and remained in France. The money borrowed by Germany in England remained in England, but was now transferred in payment of reparations to the credit of the Bank of France in English banks. The Bank of France used these credits to purchase gold from the Bank of England and exported it to France. Thus the great sacrifices we had made to return to the Gold Standard enabled France to take our gold and push us off the Gold Standard again! The irony of this situation was that our enforced departure from the Gold Standard was the greatest stroke of good fortune that has happened to us for many a long day, whilst it was one of the worst things that could have happened as far as France was concerned, unless she also devalued her currency in the same proportion as ourselves.

This great event was expected to be a disaster of the very first magnitude, and was treated as such by the same authorities who had allowed us to be placed

in the position of being pushed off again. All our resources were thrown in to the fight to remain on the Gold Standard, and it was not until every ounce of gold at the disposal of the Bank of England had been pledged abroad that we had to acknowledge defeat and allowed the pound to find its own level. Apart from other losses caused to us by the fight, the actual loss on sales of the francs and other foreign currencies which we borrowed abroad against our gold holding, was very considerable indeed. The gold holding of the Bank of England in September 1931 was £120 million. This was pledged with the Bank of France to realise sufficient francs to buy £120 million, and if the full amount was so utilised the loss to our Exchequer was about £40 million. It was claimed in high quarters that this loss was made good by the profit on the higher value of our gold holding in pounds after the Gold Standard had been suspended. This is very peculiar reasoning ; in any case the speculators who sold pounds to the Bank of England against purchases of francs, bought back a great many more pounds with the same number of francs and made an immense profit.

This profit was somebody's loss and we need look no farther than the British Exchequer for the somebody.

Incidentally if a profit could be so easily made by devaluing the pound why did we fight so strenuously to avoid making the profit ?

Our departure from the Gold Standard, an event which had been dreaded with an almost superstitious fear by our authorities, and against which they had fought so strenuously, and at such colossal cost, was

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actually the very finest thing that could possibly have happened to us. The effect was electrical. All ordinary shares at once began to rise and in spite of our supposed loss of credit and prestige, so did Government securities. Why this should be is explained on page 33. Credit was claimed for British steadiness, and for a political party or collection of parties, but strange to relate an exactly similar effect has been observed in every country where similar economic changes have taken place whatever the type of political party which happened to be in power when the change occurred and whatever the particular type of steadiness or volatility their inhabitants have displayed. If there is one reason always constant surely that reason is the correct one. Ours is not the only country that has been compelled to do as we did and others will undoubtedly be compelled to do the same in future. Similar results can confidently be predicted when the change takes place.

It was stated that our prices would rise when we suspended the Gold Standard but they did not, the reason being that we are almost the only market for many of the commodities we import, and the price we could pay had to be accepted by those selling to us. If they required a higher price in their own currency their only way of obtaining it was by depreciating their own currency and this several countries were compelled to do, for instance Australia, New Zealand, Denmark, Argentina and others as well. The drop in prices as expressed in pounds was certainly arrested for a time, but the new forces of production now available compelled such abundant quantities of



goods to find a market somewhere that our prices soon began to fall again and in order to arrest this fall, which is such a serious matter to producers, we and other countries have taken deliberate steps to restrict production and even to destroy produce. Surely just as mad a policy, whilst innumerable people are in need, as that which caused us to cling so blindly to the pre-War parity of the pound.

Before we left the Gold Standard it would have been quite impossible for us to have converted our huge National Debt to a lower interest basis. There is no question of confidence in any form of Government in question here. Again it must be pointed out that other Governments of other nationalities and of all complexions have been able to do the same as we have done in similar conditions and were just as unable to do so as we were when they clung as we did to an out-of-date monetary standard.

On a Gold Standard a country's money is linked with every other country on a Gold Standard, and the money policy of each such country must follow similar lines. If money rates are high in one Gold Standard country and low in another, money will flow from the low- to the high-interest country, and the low-interest country will lose gold. This latter country must therefore raise its Bank Rate and rates of interest generally in order to protect its gold reserve.

Consequently unless a country has a very favourable trade balance with other Gold Standard countries, it cannot lower its interest rates unless the other countries do the same.

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Once we were off the Gold Standard our Government was able to fix our interest rate at whatever level it considered best. If holders of money in this country objected to a low rate of interest they could only transfer their money to another country if they could find somebody in that country willing to transfer the same amount of money here. In other words if a holder of English money wanted to buy francs he must find a holder of francs willing to sell them for pounds. He could no longer obtain gold from the Bank of England at the old fixed price. The pressure to sell pounds caused a heavy drop in its exchange value and the demand for gold in the free market caused a big rise in its price, so that a foreign holder of our money was faced with very heavy loss if he wished to buy his own currency with pounds. As a result then of our departure from the Gold Standard our Government were left in full control of our rates of interest, and when they decided to convert the 5 per cent. War Loan to  $3\frac{1}{2}$  per cent., although the conversion was voluntary, the holders of the 5 per cent. War Loan had really no alternative worth mentioning. The Bank Rate had been lowered as this could now be done at will, interest rates were low all round and if a holder of more than a few hundreds of 5 per cent. War Loan decided to take cash instead of converting to  $3\frac{1}{2}$  per cent. all he could do was to buy other securities at a similarly high price and low yield or leave it on deposit with his bankers at a rate of interest of at most 1 per cent., probably only  $\frac{1}{2}$  per cent. If he tried to take his money abroad he was faced with a heavy capital loss.

It is important to remember that as long as we do not return to a Gold Standard at a fixed price of gold, or agree with U.S.A. and or France to fix the rate of exchange of the pound, there is no reason why the present low interest rates and high prices for Government and other high-class securities should not continue indefinitely. Even if trade was to improve to a very much higher level than at present there is no reason why money rates should be raised unless the Government wish to do so, say to stop excessive speculation. This could be done, however, far more effectively and much less harmfully if credit facilities were refused for undesirable speculation. The only thing that should cause a slump in gilt-edged security prices is a return to the Gold Standard, always excepting war. That is quite another story.

The prices of Municipal Securities and Debentures, Preference Shares and other fixed interest securities are affected by the same conditions as Government Securities, provided, of course, in the case of all except the first mentioned that the security is undoubted. The prices of ordinary shares are also influenced by the current rate of interest, but the main influence is the amount of profit made by the various companies. Ordinary shareholders are the real owners of a company, that is they own the equity and ordinary shares are often called equities. All other shareholders and debenture holders are therefore only the owners of securities representing loans made to the companies under various conditions. Deflation increases the real value of loans and so increases the

## THE COLLAPSE OF THE GOLD STANDARD 35

cost of the loans to the companies. Deflation also decreases profits in other ways so that during a period of deflation there is always a fall in the prices of the great majority of ordinary shares.

Inflation decreases the real amount of all loans and also assists profits in other ways, consequently during a period of inflation there is a rise in prices of the great majority of ordinary shares. The prices of houses, and land, rise during inflation and fall during deflation, provided that the houses and land are not affected by special circumstances.

Below is a comparison between 1912 and 1935 from the Midland Bank's *Monthly Review* as reported in *The Times* :

In the Midland Bank's current *Monthly Review* a comparison is made between financial events in 1912 and 1935. In August 1912, Bank rate was raised and, notwithstanding this, sterling weakened steadily in terms of dollars. In October war broke out between Turkey and Balkan States, a widespread process of financial liquidation began and Bank rate was raised further. The Review points out that the weakness of sterling outlasted the period of tension, and goes on :

" For a considerable period the prices of long-term capital and of short-term credit, that is, rates of interest generally, were unduly high, in the sense that industry, trade, and capital enterprise had to pay more for their finance than they would have paid but for a series of unfavourable events. These unfavourable events were entirely of external origin."

The Review then refers to events in recent months in connexion with the Italo-Abyssinian crisis and comments as follows :—

" The results of the enormous gold outflow were amazingly slight. There was no rise in Bank rate ; nor was

any increase recorded in the charges for long-term capital or for short-term credit required by industry and trade. Yet in 1935, as in 1912, London showed once again that, as a leading international centre, she is subject to heavy and sudden withdrawals of funds for reasons quite unconnected with her own domestic position or the inherent condition of her own currency. Thus far the experiences run parallel, but at this point they part. For whereas in 1912 the effects of London's international position were inevitably transmitted, for good or ill, to domestic industry and trade, in 1935 the effects were insulated, and industry and trade, so far as financing was concerned, were free to go on peacefully and uninterruptedly with their business."

The Review concludes by quoting with approval a recent statement of the Chancellor of the Exchequer that if this country were to go back to the gold standard we should no longer be free to adapt our policy to domestic requirements, but would have to adjust it according to conditions oversea over which we had no control.

Immediately the Gold Standard was suspended our trade began to improve. The drop in the exchange value of the pound meant that all our exports became immediately cheaper to foreigners to the extent of the pound's depreciation. A Frenchman who at the beginning of September 1931 had to pay 125 francs for say a ton of our coal, could buy it for 85 francs at the end of September of the same year. The price of a British car abroad dropped by 40 per cent. and for the first time since the War the British car began to make headway abroad against American cars. Even Japan immediately felt the effect as our cotton goods became so cheap abroad that Japan could not compete. This did not last long, however, Japan quickly went one better than us in currency depreciation and in-

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flated so substantially that the yen fell from about 3s. each to about 1s. 2d.

This depreciation of the yen is one of the prime factors in Japan's ability to compete in foreign markets. But deliberate depreciation of a currency to obtain advantage in foreign market is not a solution for the world's difficulties.

Besides the depreciation of the pound two other factors helped our trade. One was the cheap money policy which the Government were now able to pursue as explained previously. Bank Rate was reduced from 6 per cent., at which it stood on September 21, 1931, to 5 per cent. on February 18, 1932, and from that date it was reduced by stages to 2 per cent. on June 30, 1932. The last time Bank Rate was 2 per cent. was in May 1897. The Bank of England was also enabled to enlarge the basis of bank credit and to enable the banks to create more deposits. (See chapter on "Gold Standard.")

The figures given below are from *The Times* of September 8, 1936, of eleven London Clearing Banks, not including District Bank.

(ooo's omitted)

	Deposits.	Cash.	Cheques in Transit.
August, 1931 . . .	£ 1,745,006	£ 179,846	£ 42,646
" 1932 . . .	1,850,620	192,570	40,904
" 1933 . . .	1,965,594	208,108	40,170
" 1934 . . .	1,855,832	196,440	40,624
" 1935 . . .	2,013,231	213,300	41,688
" 1936 . . .	2,170,448	225,619	50,238

(ooo's omitted)

	Money at Call.	Bills.	Investments.	Advances.
	£	£	£	£
August, 1931	113,208	263,643	301,755	908,548
" 1932	117,504	374,354	363,534	816,213
" 1933	90,714	359,047	563,385	758,154
" 1934	138,544	221,696	557,249	756,100
" 1935	148,549	286,868	615,217	764,511
" 1936	155,758	337,744	612,406	845,076

There is no valid reason why bank cash should not be further increased and deposits correspondingly. The resulting inflation of credit would be available to finance a much larger improvement of trade than has yet taken place. A cheap money policy, although it assists building, and thus trades affected by building operations, is not by itself sufficient to make a really big improvement in trade. (See chapter on "Cure of Unemployment.")

Our departure from the Gold Standard had immediate repercussions all over the world. Those countries which followed our example and devalued their currency immediately felt the benefit and shared in the improved trade. Those that did not follow our example have felt the full force of the increased competitive power of the other countries and the deflationary effect mentioned later in this chapter. Each country that has clung to the Gold Standard has had bad trade and constantly recurring political and financial crises. Some countries linked their currencies with ours and became known as the "Sterling Area." Of these

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Sweden has been conspicuously prosperous although with a Government of quite a different political complexion from ours. South Africa at first clung to the old Gold Standard, but at length found the position untenable and from the day she rejoined the Sterling Area has had unexampled prosperity. All this does not mean that mere devaluation of currency is the way to achieve prosperity, but it does mean that an overvalued currency is a sure way to depression. What is essential is that internal prices should not be forced either up or down by too little or too much currency and credit. There is a happy medium and it is essential that the correct level should be found and maintained.

Apart from the increased competition of other countries the Gold Standard countries were also affected in another way. Their exporting trades being compelled to accept the prices which the "off gold" countries could pay, obtained much smaller sums in their own currencies than they had had before. For instance a U.S.A. exporter of cotton might receive the same number of pounds per bale, but when this amount was converted to dollars he found he only obtained about \$3.30 instead of about \$4.85 for each pound. This meant he must reduce his costs or go out of business.

It also caused the U.S.A. internal price of cotton to fall heavily as prices of commodities dealt in on the world market always tend to become equal in each country. The prices of practically all its other commodities also had a severe fall. The banks who had lent against these commodities soon found their loans in many cases above the value of their security.

The lowering of wages, decreased purchasing power,



and naturally decreased trade. The cumulative effect of lower prices, lower wages and decreased trade threw an ever-increasing strain on U.S.A. and this, added to the effect of the deflationary policy which had been instituted to check the excessive amount of Stock Exchange speculation caused a tremendous drop in commodity and Stock Exchange values, many banks were unable to call in their loans and were compelled to close, and eventually the economic life of the country almost collapsed. All the banks were shut for a time and were only able to open when Mr. Roosevelt obtained power to devalue the dollar and so at a stroke raised all internal prices of commodities and was also able to create an enormous additional amount of credit based on the increased value of the U.S.A. gold holding at the lower value of the dollar. This credit he was able to lend to the banks and enable them to reopen. It must be remembered that the collapse was not due to any lack of gold or to an adverse balance of trade, for U.S.A. had an enormous holding of gold and as a result of the War U.S.A. is now a creditor nation, in other words other nations owe much more to U.S.A. than she owes to them. The collapse was due to the compulsory lowering of prices due to our leaving the Gold Standard and U.S.A.'s own deflationary policy. At the time of writing, France, Holland and Switzerland still cling to the Gold Standard, but it can only be a question of time before they are compelled to devalue. They are suffering extremely severely for their obstinacy, or shall we call it stupidity, but it can be safely predicted that they will experience relief immediately they devalue. Other countries will also

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feel the benefit, for each country suffering from trade depression is naturally a bad customer to the others. In the long run it pays no country to snatch a temporary advantage at the expense of another. The benefits of currency devaluation are only slightly due to the temporary advantage it gives to the export trade of the country which devalues. The real benefit is the relief it gives to the internal situation of a country. It is the relation between debtor and creditor which is of such vital importance. Traders, manufacturers and workers are all in the position of debtors and if falling prices makes their position intolerable it is bad for the creditors as well as themselves. No creditor desires a bankrupt debtor or to strangle the trade or production of his debtor on which both debtor and creditor depend for their existence.

## CHAPTER V

### THE COST FALLACY

WE have had over two million unemployed since the War, and no real attempt has been made to cure unemployment. In fact, it has been quite frankly stated by some of our most responsible leaders that it cannot be cured. Surely this is utter nonsense. There is plenty of work waiting to be done, urgent and necessary work. Work which if done would add greatly to the health and wealth of the whole community. Why then is it not done? The answer is in one word, "Cost." The great majority of our people sympathise with the unemployed or are themselves afraid of unemployment, but the great majority shake their heads and ruefully state that we cannot afford to cure unemployment as the "Cost would be too great."

We use the word "*Cost*" in a very misleading way. We use it when we wish to measure the amount of money spent, when anything is done or made, and the inference is that so much money has been used up and lost. Consequently when it is necessary for the nation to consider spending money for some very necessary and desirable purpose we are afraid to spend as we should because we are afraid money will be lost and we shall be poorer. *In actual fact nothing has ever cost anything in money.* The cost of everything is

not money, it is really labour and materials. We have both in superabundance and if, when considering whether a certain thing should be done, we always remembered this fact, a very different complexion would be put on the matter. The error in the use of the word "Cost" arises from two things, first, the outlook of the individual towards money and, secondly, that in the past it was much more difficult to produce things than it is now. Consequently it was essential that money should not be increased quickly, as if this was done prices rose rapidly and money lost a large part of its value. It was also essential that money should not be spent too quickly, as quick spending has a very similar effect to creating money quickly with similar results in rising prices. (Conversely when the rate of spending is slowed down for any reason it has the effect of a withdrawal of money from circulation and causes a fall in prices.) Under modern conditions production is so easy that unless money is created in sufficient volume and unless it is spent sufficiently quickly, prices are bound to fall, due to the potential immense supply of goods. Restriction of production cannot possibly be anything more than a palliative.

Restriction of production must mean less employment and consequently less purchasing power and thus more unemployment, unless those unemployed are paid far more than they are at present.

Now let us look at this question of cost from another angle. If the War taught us one thing it should have taught us that the sense in which we use the word *Cost* is absurd. The cost of the War was colossal

but we and practically every other country finished up with more money than we had when we started. This is not an argument for war, at least not the kind of war of 1914-18. It is certainly, however, a splendid argument for a war against poverty. We are constantly speaking of such a thing costing so much. We speak for instance of the new liner *Queen Mary* as costing so many million pounds, but suppose the country had borne the whole of the cost would it be so many millions of pounds the poorer in money when the ship was built? Certainly not, there is more money in the country after the building than before. In fact, during the period the *Queen Mary* has been building we have increased our gold holding, our note circulation and our bank deposits, just as we did during the War. How then can this be? If we spend money how can we still have it? But this is always what happens to a country, but not of course to an individual. It is extremely important to remember this difference between a country and an individual, but also at the same time to remember that if an individual does not spend, some other individual suffers a loss of income and this loss of income may react on the first individual and may even put him out of employment.

Let us return, however, to our example. After spending millions on building a *Queen Mary* why is it we have more money than before? The reason is of course quite simple and everybody knows it. The cost of the *Queen Mary* is the wages of the workman who built the ship, or made the engines or made the steel or dug up the coal and iron to make the steel

or transported the materials or designed the ship or organised the building and of all the thousands of other people who do something towards building the ship.

Then of course there is the cost of the raw materials, either home-produced or imported.

As each person was paid his or her share, what did they do with it? They (of course) spent the greater part and possibly saved a part, after of course paying income tax to the Government and rates and taxes to the Local Government, and every time they spent the money *no money was used up*, it was merely transferred to somebody else, nobody burnt their money and very little was buried, if any. Therefore the money remained either in the banks or in people's pockets. Where else could it be? Oh! yes, you will say, we all know all this, why do you make such obvious statements? to which my answer is if you know that money, if spent, still remains here, why do you refuse to spend it on the many things we need, especially as if it were spent you as individuals would most certainly benefit considerably. Oh! but, you say, as individuals we can only spend what we can afford and we must save if we can in case we may need money urgently later on. This is quite true, but it is not true as regards the Government of a country. The great mistake is in looking at the matter from your point of view as individuals when Government spending is under consideration, and in supporting a policy of economy in order to reduce taxation, when in fact the policy of Government economy has just the reverse effect. During the War when Government spending was on a scale never before heard of, the income of

the country as a whole was rising rapidly. The disastrous mistake was of course that this spending was mainly for destruction, if it had been spent on construction the country would have been immeasurably more wealthy than it is now, and if we were now to start spending say a thousand millions on reconstruction, we should finish up with more gold, more money in circulation and higher bank deposits. Why not do it? Where is the snag? There is of course a limit to the spending. This would be reached when all our unemployed were in regular jobs at good wages, or if there was a shortage of the things we wished to buy. But there is no shortage in sight of anything that could reasonably be desired, just the reverse, as everybody knows we are now compelled to restrict production, and incidentally increase unemployment, in order to prevent our markets being flooded with things that we cannot buy because there is either not enough money available or we are afraid to spend.

But how about things we have to buy abroad? To this my answer is "How much do we have to buy abroad and what are the things?" Raw materials, say such as wheat, cotton, oil, rubber, tea, tin, copper and so on. But are not many of these things produced by companies abroad of which the shareholders are mainly, if not entirely, our own people? In fact, the proceeds of the sale in this country of these commodities are distributed in this country, either as dividends to the shareholders of the companies producing them or as payments to the directors, managers and officials of the companies. As far as concerns the other things we need from abroad there is no sign that the

countries selling them to us are not willing to do so. Quite the reverse, we have been compelled to put a tax on imports in order to restrict and reduce them, and other countries compete fiercely with one another for the favour of selling their goods to us. Also it must be remembered that when they receive payment for the goods in our money, this money can only be used by them to purchase our goods, or the goods which our companies working in the colonies, etc., produce. As proof of the above reasoning: All the countries which send us only raw materials owe us much more than we owe them, nearly all their currencies are at a discount compared with ours, and in many cases they cannot pay us what they owe us because we do not buy enough of their goods. In fact, we are steadily increasing our gold holding because our income from abroad plus our sales abroad are together much more than our purchase abroad, and the balance is being taken in gold as we have largely suspended lending abroad.

Why then do we not pay U.S.A. the very large sum we owe to them? The answer is that U.S.A. does not want our goods, and does not really want our gold, she has too much already, and does not want to depreciate our pound as she is afraid of its effect on her own economy. In fact, one of the reasons U.S.A. is buying silver is to enable her to keep the value of the pound from falling. By taking silver she is also enabling us to take gold. We could easily pay off our debt to U.S.A. if she would take our goods, and if she was involved in a war and we were neutral we should very soon be able to repay all we owe.



CHAPTER VI  
THE PLACE OF MONEY IN THE NEW  
MACHINE AGE

THE position of money in the present system is an extremely important one. With money everything is easy, without it, everything is almost impossible. Money is used continually in small or large quantities, and none of us can do practically anything without it. With it we can be almost independent, without it or in order to obtain it we are the willing slave of anybody who is prepared to pay for our services. The possession of sufficient money is in many respects far more advantageous than the possession of the magic lamp was to Aladdin. The owner of sufficient money can live in perpetual summer, travel in the greatest of comfort in practically every country of the world as an honoured and welcome guest. Everywhere, everybody is only too anxious to do his bidding, of course on payment, but should his money be not forthcoming he would be very lucky not to find himself in prison. Provided, however, he is really entitled to sufficient money he will find some of the most powerful organisations of the world combined to see that he really gets what he is entitled to, and that his money is not taken from him. Poverty is not a crime but it is punished far more severely than almost any crime.

Money is of very great importance, and its issue and control are of the very greatest importance to every man, woman and child.

Gold has now disappeared from circulation. Silver and copper money are used for small transactions, paper money and cheques for larger transactions. Silver and copper money are issued by the Government as they find a demand. Paper money in this country is issued by the Bank of England partly against its gold holding, and partly on behalf of the Government, the latter part is the fiduciary issue, and is actually only Government credit. But where do bank deposits come from? and who determines their amount? These are two very important points, for the total money turnover in the form of cheques is enormous and is continually increasing.

The following is an extract from *The Times* of August 14, 1935:

#### CAUSES OF BANK DEPOSIT EXPANSION

"The deposits of the London Clearing Banks in July reached a new high level—namely, £2,019,311,000—an increase on the month of £15,860,000. Compared with a year ago the increase amounts to no less than £148,498,000. It may seem strange that with less demand for money than has been known for some years—largely the consequence of the breakdown of the system of international finance and trade, causing money rates to fall to unprecedentedly low levels—the amount of deposits of the banks should nevertheless go on increasing. As it is really the depositors themselves and not the banks who decide how large or how small their deposits shall be, it follows that the customers of the banks, for one reason or another, must have acquired larger resources, and yet have no

immediately attractive use for them outside the banks. Certainly the larger deposits cannot be due to the rates payable by the banks, for these have never been lower than they are to-day. Part of the increase in deposits no doubt arises from the sale of securities by depositors to the banks which have added something like £65,000,000 to their holdings in the past year. Also the increased volume of trade and the higher level of profits and incomes will have put more money into the hands of the people generally, which is reflected in the deposits. Another, and possibly quite an important, factor has been the flight of foreign capital to London. In the course of buying foreign currency the Exchange Equalization Fund would have sold sterling which would have been provided by an issue of Treasury Bills. Further it may have been noticed that the increase of the floating debt in the past year—namely, £46,035,000—is substantial, and that this represents for the most part a creation of credit. During the past month the banks have reduced their investments, the total having dropped from £624,188,000 to £615,206,000. At the same time the holding of bills has increased by nearly £30,000,000."

To begin with it is quite wrong to imagine that bank deposits are there because the public choose to place their money with the banks, the public are by no means free agents in this matter, the total of bank deposits also does not depend on the public. Very few people with a banking account carry much cash with them, it is far more convenient, and far safer, to carry a cheque book—even if they are travelling in Great Britain or abroad, in practically any part of the world their banker will provide them with travellers' cheques or a letter of credit, so that they can draw the money of practically any country up to the amount of their credit. It is found that the total cash in the hands of the public is normally very constant and is

only increased to any extent over the average for each year during such periods of extra spending as holiday times and Xmas.

In Great Britain the Bank of England is the other bankers' bank. Any cash over and above that required to meet the estimated cash requirements of their customers is deposited by the bankers with the Bank of England. The bankers have by long usage found that it is quite sufficient to keep about 10 per cent. of their deposits in cash in hand or at the Bank of England; the balance is lent in various ways, part for very short periods and the rest for longer periods, so that if they should experience a sudden call above the average they can easily obtain money at short notice. Usually the longer the period which would be required to obtain repayment of a loan the higher the rate of interest charged. On short-term money the rate of interest is very low, at present the banks have great difficulty in obtaining interest at rate of  $\frac{1}{2}$  per cent. per annum for such money, at times they have been compelled to accept less. The Bank of England and the Government between them determine how much cash in hand and at Bank of England the banks in the aggregate shall be allowed to have, and the banks can then so arrange their lendings that their deposits are about ten times their cash. The banks' income depends to a very large extent on the interest they obtain on the money they have lent, so it is obviously in their interest to lend up to the full amount they are allowed to, that is ten times their cash holding, although there are times when the banks are unable to lend profitably the full

amount of money they could, under the system of ten times their cash. Their ability to lend in this way depends on their position as practically the only place where money can be deposited and drawn on demand by means of cheques. It must be remembered that when payments are made by cheque no money passes and none leaves the banks. Even when money is actually drawn out to make cash payments, as for instance wages, the great majority of this cash is back in the banks again in a very short time, most wages are soon spent either in rent, shopping, fares, etc., and is almost universally banked as soon as possible, even savings are of course usually put in the bank. The Government also keeps its account with the Bank of England and the Government is continually receiving enormous sums of money from the public in payment of the many forms of taxes. Entertainment tax and income tax are pretty obvious forms, but every time a profit is made or rent or interest is paid the Government takes a share, and the money, of course, finds its way to the Bank of England. The Government and the Bank of England between them, as already stated, determine the amount of cash in the hands of the banks, and as they know the banks will endeavour to keep their cash ratio to deposits at 10 per cent. they are able to determine the total amount of deposits in the banks within a quite small margin. If they wish to reduce cash with the banks they can do so in various ways, one way is for the Bank of England to sell Government securities on the Stock Exchange, the cash in exchange for these securities is then received by the Bank of England, and so

reduces the amount of cash in the hands of the banks. The banks are then compelled to restrict their lendings in one form or another and so deposits are reduced. If these measures are not sufficient to bring about the desired amount of deflation the Government increases taxation and starts an economy campaign. Both have the effect of slowing down spending, and consequently prices fall and trade is depressed. If further deflation is still required, cuts in wages and salaries are instituted and inevitably there is a further fall in prices and still deeper trade depression. Now that we are no longer on the old Gold Standard and it is desired to increase deposits and to make money cheap and plentiful, all that is necessary is for the Bank of England, by arrangement with the Government, to buy gold and/or securities and so place more money in the hands of the banks, who are thus able to lend more and so increase their deposits. The Exchange Equalisation Fund is an important factor in the machinery now being used to manipulate our monetary policy. If the banks are unable to lend direct to the public they usually buy Government securities. Government securities are, of course, only another form of loan, a loan to the Government and not direct to the public. Since we were compelled to abandon the old form of Gold Standard in September 1931 there has been an almost continuous rise in the price of all forms of Government securities (see figures as given in *The Times* of December 30, 1935),\* and the explanation for this and for the cheap and abundant money that is now available, is to be found in the power of the

\* See Appendix.

Government and the Bank of England to dictate to the banks the terms on which they will borrow from them, and also their ability to determine the amount of cash to be left with the banks and so the amount of their deposits and how much they can lend. On the old Gold Standard although the Bank of England and the Government had the same power as regards the banks, they were unable to dictate the terms on which they could borrow, as customers of the banks then had the right to take gold from the Bank of England, and if rates of interest were low in this country as compared with other Gold Standard countries they would withdraw gold and send it to a country with a higher rate of interest. To avoid this loss of gold the Bank of England was then compelled to raise its Bank Rate and thus all interest rates throughout the country. Under the Gold Standard the amount of currency was restricted by our gold holding, and as explained above the amount of deposits in the banks is determined by the cash holding of the banks so that a loss of gold when on a Gold Standard meant that deposits had to be reduced. To do this the Bank of England, if it could not retain its gold by means of a higher Bank Rate, had to sell Government securities to reduce the cash in the hands of the banks and the banks had to restrict their lendings in order to reduce their deposits, this had a bad effect on our trade. Now that we are no longer working the old Gold Standard, we are no longer tied to conditions in other countries, and are able to pursue the monetary policy which we decide is best. In fact, our money is now based on its purchasing power, and this is decided

by our ability to produce and on the credits we receive, as explained in a later chapter, from various sources all over the world. Even on a Gold Standard this was always the real basis of our currency, but we then used our gold holding as a kind of barometer to indicate our financial weather, but it was a very bad indicator as it often showed "Stormy weather" here, when in fact the storm was in other countries and we were compelled to take measures here which exposed our own trade to the storm.

The old Gold Standard is totally unsuited to an age of immense productive capacity, but there is still serious danger that we may have some of its bad features again imposed on us. There is constant agitation to "stabilise our currency," that is to fix the rate at which the pound can be changed into U.S.A. dollars and French francs. Once this is done we immediately lose our control over our monetary policy, for we shall be compelled to take into account conditions in U.S.A. and France, as, if rates of exchange are fixed, money would flow to whichever country offered the highest return and, in order to protect the agreed rate of exchange, we should have to keep our interest rates at an attractive level. Even worse, we should if necessary have to take steps to maintain the value of our money as expressed in terms of dollars and francs, and if for any reason either France or U.S.A. decided to deflate and raise the value of their currency we should be compelled to follow suit. Nothing is so bad for trade as deflation.

In the new machine age we require a currency which can be expanded and contracted to meet our needs.



With constantly rising wages and salaries and profits the amount of money required to finance the greatly increased national income will be much greater than at present, although not necessarily in the same proportion as the rise in income, as a much larger number of people will be able to afford banking accounts and a much larger proportion of our trade will be financed by the cheque system, and actual currency will not be required for these transactions.

It is inevitable that while incomes are rising the amount of currency required will also rise considerably, but there is no reason for alarm in this provided prices do not also rise to any great extent. It must be remembered, however, that unless we are prepared to allow an increase in currency and rising wages and salaries, with the new methods of production now at our disposal, a flood of new production may make its appearance at any time, in spite of all efforts to restrict production, with disastrous effects on price levels, for it is a disaster to producers if prices fall rapidly unless a considerable rise takes place in consumption. We have no choice in the matter, we must either be prepared for drastic restriction of production and a great increase in the army of unemployed, or a great increase in our currency with a big increase in wages, salaries and profits, much shorter hours and much longer holidays. The proper utilisation of leisure will of course be a problem, but surely this is not incapable of solution and of the two alternatives given above the latter is the only one that is sensible and reasonable.

## CHAPTER VII

### THE CURE OF UNEMPLOYMENT

*THE way to cure unemployment is to :*

1. Raise wages.
2. Reduce hours.
3. Increase holidays.
4. Resume lending abroad.
5. Reduce taxation.
6. Increase Government spending.
7. Increase production.

Objections will be raised to all the above, and these will be dealt with before outlining the proposed method of putting the scheme into operation.

#### RAISE WAGES AND REDUCE HOURS. INCREASE HOLIDAYS

The usual objections to the above are that they will increase the cost of production and raise prices, so that we shall be no better off, and that we shall not be able to compete with abroad. Now let us examine these objections. What are the costs of production ?

Wages.

Profits.

Rent.

Interest.

Advertising.

Depreciation.

} Overhead charges.

The outstanding fact of our present situation is that owing to the use of machinery the wages cost per article is being reduced to an amazing degree, see for instance the case of the Dunlop Rubber Co. quoted in the introduction.

Part of the gain from the use of machinery should go to the workers in increased wages and salaries, part to the consumers in reduced selling prices, and the balance in increased profits. This does not mean that the rise in wages should be small, on the contrary it is essential that the rise should be substantial and eventually very considerable, as the decrease in wage costs is already very large indeed, and the decrease is by no means at an end. The rise in wages will, therefore, not cause a rise in prices but will help to arrest a fall. A fall in prices is a very serious matter to producers if sales are only maintained or only slightly increased. If sales are increased sufficiently to realise a sufficiently larger total sum, the profit in the increased turnover, although at lower prices, may easily be much more than at higher prices. But higher wages are essential to provide the increased purchasing power that is required. With higher wages, demand for the various articles will increase, this

will enable the overhead cost per article to be reduced and allow a further reduction in selling prices and another increase in wages and profits. If wages are not increased who is to purchase the increased production? The articles produced may not be suitable for those in receipt of rent interest and profit, also the latter are more likely to be able and willing to save their money than those in receipt of wages and salaries, and consequently demand will be insufficient to keep production at full capacity, and profits would fall if production is not maintained. It is therefore necessary to raise wages and lower prices every time there is a sign of demand falling off, in order that production can be fully maintained and increased. Profits will inevitably rise if this is done and a steady fall in prices will also result, all due really to the improved machinery. This is borne out by experience, the motor-car industry is a case in point. In this industry higher wages, lower prices and higher profits have gone together. If wages had been raised further, prices would be still lower and profits even higher, all due to the increased production made possible by machinery, but made impossible if wages are not sufficient to buy the increased production.

If prices had been lowered more than they have been it would be a stimulus to sales and so to production, but a drop in prices not only benefits wage and salary earners, it also benefits receivers of rent, interest and profits who it must be again pointed out are usually not so willing to buy.

As their wants are already much more largely satis-

fied than those of wage and salary earners and they are, therefore, more likely to save, which after all does not create trade. In passing it is worth pointing out that in U.S.A., where wages are much higher than with us, the prices of their motor-cars are very much lower than ours, and the total profits of the motor-car manufacturers are very much higher than with us.

#### HIGHER WAGES AND FOREIGN COMPETITION

Now as regards foreign competition. (1) Why do we compete with foreigners? (2) Do we actually compete with foreigners? (3) Is it true that foreign trade is of vital importance to us and we could not exist without it? (But it is strange that international trade has been decreasing with great rapidity whilst we have generally been getting better off).

Let us consider the first question. "Why do we compete with foreigners?" Surely the only reason is in order to obtain the raw materials we need, as we can do practically all our manufacturing for ourselves. We can, however, get all the raw materials we need from the Colonies and Dominions and from such foreign countries as Argentina, in which we have invested large sums. In fact, the Colonies and Dominions are very jealous indeed of our market for their produce, and would very much like to have it all to themselves. They certainly do not like us going to Denmark for instance for bacon, butter and eggs, etc., or to Argentina for wheat and meat or to Russia for wheat, timber and oil. In all these commodities

and all raw materials there is no scarcity, on the contrary there is superabundance, so that we do not, therefore, need to compete with other countries for them. Let us consider the chief countries with which we are supposed to be in competition. Germany, U.S.A. and Japan. Germany is undoubtedly in need of certain raw materials and can only obtain them by selling her goods to countries which can supply them, she cannot, as we can, obtain them in payment of interest on money lent, as dividends on investments, and payment for services rendered as Colonial Administrators, or pensions to retired Colonial Civil Servants, or in payment for an army serving abroad and pensions to its Officers, etc., as we have in India and elsewhere. Or as payments as salary and pensions for present and past managers, etc., of the concerns abroad in which we have invested money. We obtain large credits available for purchase of raw materials in all of the above ways, but Germany does not do so to any extent. But we are also anxious to sell manufactures abroad as we have a very large surplus manufacturing capacity; how are we, however, to obtain payment for these sales to countries outside the Dominions and the Colonies unless we accept goods? If these goods are raw materials they compete with the Dominions and Colonies, and if manufactures, with our own. The only alternative is for us to resume our old rôle of lending abroad, but without any hope of ever being repaid except in case of war, when the credits abroad would be very useful indeed.

There are many countries abroad now which owe us very large sums of money and are unable to pay

us because we will not take sufficient of their goods. Some cannot buy as many of our goods as they would like and others are unable to buy enough raw materials for their needs, as we have been able by means of our position as a substantial buyer to insist on raw material countries taking our goods in preference to those of Germany and similar countries. If we were willing to lend again, these countries could sell more of their goods and, therefore, buy more raw materials and we should still be able to sell our manufactures abroad.

The position is then that we need not compete with foreigners, but as we wish to sell abroad we can only do so, and allow foreign countries which have not our advantages to obtain raw materials, if we will lend abroad. All the three questions have been answered together, but another question will at once arise, suppose our wages are raised considerably, how will this affect the position. The answer is, first, if wages are raised here we could buy more raw materials and foodstuffs, so that even if the prices of our goods were raised owing to higher wages, our customers could afford to pay more, and secondly, with a bigger turnover as demonstrated previously, overhead charges are reduced per article made, and it is far more likely that higher wages owing to improved machinery would lead to lower prices and not higher prices.

The statement that we must not raise our wages, as to do so would make it impossible to compete with abroad, is therefore entirely fallacious although on a superficial examination it appears unanswerable.

Before leaving this subject the position of U.S.A. and Japan should be mentioned. The position of U.S.A. is that before the War she owed very large sums of money abroad, mainly to us, which had been used to develop her enormous country. During the War she repaid nearly all she owed and in addition lent enormous sums abroad. Her industries, however, had been developed to a very large extent for the purposes of export, and the products were sent out not only for payment of imports but in payment of interest and dividends. She is very largely self-supporting owing to her enormous area and extremely rich territory, and could now obtain all she needed from abroad in payment of the interest on money lent abroad during and just after the War. But if she did this the large part of her industry which was created in order to supply the export market would become derelict, so that she is in a similar position to ourselves, she does not need to export to buy imports, but only to employ part of her manufacturing capacity. Lending abroad would also ease her problem, but it is individuals who lend abroad, and they require interest on their money which they could only obtain if U.S.A. would accept large imports or refuse to export, and she is not willing to do either.

Her solution of the problem so far has been to buy gold and silver in enormous quantities. She has now much more of the former than she can ever possibly require, and as for silver she produces large quantities herself, and every bit she buys is merely adding to an embarrassment of riches.

Japan is in a quite different position. During the



War she was able to develop her industries and her manufacturing capacity to an enormous extent, and did so with great skill and organising capacity. She, of course, benefited by our previous experience, but that she showed her ability to do so is a sign of her capacity. Her people are highly skilled in many light industries and quickly adapt themselves to machine technique. They had been organised for centuries on a form of feudal system which had not been really overthrown when the new factory and machine production was adopted by them.

The new system has in fact been grafted on to the old, and partly due to this the money cost of production is extremely small.

No Western nation could possibly sell goods at a price at all comparable with some Japanese prices. The result has been that other nations have done their best to exclude Japanese goods and, where possible, have used their position as large buyers to compel sellers to take their own goods in preference to Japanese, even though at much higher prices. Japan, finding herself thus being shut out and being determined to maintain and develop her industries, has adopted what is called an Imperialistic policy. She has practically annexed Manchuria, and obviously intends to compel it to supply her with raw materials, and to buy her manufactures. It also appears pretty certain that she intends to compel China by various means to do the same. Germany has no such outlet and consequently our refusal to lend abroad seems very much like our sitting on the safety valve.

## A PLANNED ECONOMY

It is, therefore, essential that we raise wages, reduce hours, increase holidays and resume lending abroad. Our ability to do this is because of the many credits due to us abroad, as previously explained, and to the enormously increased productive capacity now available owing to machinery, etc. In fact, we have no option but to adopt this policy if we are to maintain prosperity. If we measured machinery in terms of man-power instead of horse-power possibly the position would be more understood. We are now able to provide for all our needs on a far higher scale than ever before, and to provide these needs a much smaller man-power is required. What are we to do with the balance? Support it on a subsistence level or share the work and share the proceeds. Which is common sense and which is to everybody's advantage? It is not only a question of sentiment, it is a question of sound business. Even the man who under present conditions is assured of a good salary, and has no fear of unemployment, would benefit very considerably if unemployment were cured. At present the unemployed have to be supported out of taxation and cannot themselves contribute much towards the tax revenue. If they were employed it would no longer be necessary to provide for them out of taxation, and they would also contribute very considerably towards the tax revenue. This would enable taxation to be reduced, and this would, of course, confer great benefits on those in receipt of fixed incomes. The Government should not, however, wait till unemploy-

ment was cured before reducing taxation ; they should reduce taxation first, and rely on the increased spending power thus released to improve trade and thus tax revenue. To enable the enormously increased productive capacity of the machine to be utilised it is becoming ever more urgent that increased purchasing power should be available, and this increased purchasing power should be created by all the means at our disposal so that it is spread over all classes of the community. The increase must, of course, be regulated so that such production as is available is absorbed. Various classes of the population absorb different types of production and each class obtains its purchasing power in different ways. The Government should set up an Economic Advisory Committee and a special Economic and Statistical Department to deal with production and consumption. The Government by its control of taxation has a very large measure of control over consumption. In the past when production was only a comparatively small trickle it was reasonably safe to allow it to flow unrestricted and uncontrolled, but now that new forces have been released, and production threatens to become an overwhelming flood, measures must be taken to control it. This does not mean trying to dam it up or to destroy it. It must mean, however, regulated and controlled production and regulated and controlled consumption, one follows on the other.

We must have a planned economy not because we want it, but because it is being thrust upon us whether we want it or not.

The task of planning will undoubtedly be a big one,

but why should it be beyond our capacity? There is no reason to be afraid that by planning we must have a servile state. The degree of regulation will naturally be determined by each country according to its own temperament, and there is no reason why we should not plan to have much more freedom than we have now. Why should not the machine release us from drudgery and ugliness? There is no reason why we should be the slaves of the machine. The machine can be our very obedient slave.

The Government and the Bank of England between them, as already demonstrated, now control our currency policy and with it our rate of interest, the total of our bank deposits and the amount of taxation. As a consequence of the above they can determine our price level and our incomes. To what extent the new plan is to be worked by private enterprise or Government and municipal enterprise is entirely a matter for the public to decide. As is usual with us it is almost certain to be a matter of compromise. It is, however, certain that the longer a decision is delayed the more urgent will action become.

We have to raise wages, reduce hours, increase production, increase leisure, and stabilise purchasing power of money in terms of purchasing capacity. The best way to raise wages is to increase the demand for labour, in this a compulsory reduction of hours would be of great assistance. Increased purchasing power and increased leisure would also increase demand for labour, to set off against this will be the effect of further improvements in machinery and organisation, mass selling, etc. A survey of the whole country

should be undertaken with the object of improving its efficiency in every possible way. We could improve drainage, roads, railways, aerodromes, houses, shipping, docks, etc. The aim should be to build always with the best materials and in the best possible manner. This country has an extremely favourable geographical situation with an extremely healthy climate and immense mineral resources. If our roads were turned into parkways, if smoke was abolished and our towns replanned and made beautiful, it would not only pay handsomely from the æsthetic point of view, but would return handsome dividends as a sound business proposition. If we add to these improvements sufficient food of the best quality to all our population, the effect in improved mental and physical health and physique would be tremendous.

Nobody doubts we could do all these things if we only had the money. I trust nobody who has read this book, now doubts that we have the money, or could have it if we make up our minds to do so, so why not proceed? Illness and poverty do not pay, why not scrap them? The first initiative must be from the Government, however much private enterprise is relied on later. Let us imagine the Chancellor of the Exchequer delivering his first speech after a policy of reconstruction such as outlined above had been decided on.

The Minister of Reconstruction has informed me that he will require a first instalment of £500 million to commence his operations. He has received many schemes of reconstruction from numerous municipalities and these have been submitted to the co-ordinating

committee where necessary, or grants will be made as soon as the necessary finance has been provided.

The Foreign Exchange Committee have advised me that part of the very large sums of money held by our nationals in foreign countries, and which they were unable to remit home owing to exchange restriction, have now been used to purchase foodstuffs and raw materials in those countries. A large number of the ships which have been lying idle for so long are now on their way to fetch these commodities, and as a consequence I am pleased to inform you that unemployment amongst our sailors has been very greatly reduced. I anticipate a large increase in the consumption of foodstuffs, but am informed that the provision of special storehouses all over the country for the reception of these and other commodities is very well forward. I would mention that as anticipated no difficulty was experienced in exchanging the credits in foreign countries in the hands of our nationals for credits in England. These credits were readily discounted by the banks as they had of course our guarantee against loss, and the sale of the goods being imported will go towards liquidating the credits, any balance will be advanced by the Exchequer. I am also pleased to inform you that the ships mentioned will not go out empty. A greatly improved inquiry for our goods has already been met with from abroad, and our manufacturers showed enterprise in sending out goods in anticipation of the improved demand. This and the fitting out and fuelling of the ships has already had a very beneficial effect on our exporting industries.

The emergency credits and reduction of taxation sanctioned when we first took office have already had great effect on our retail trade, and I expect this will continue, and although the deficit on the budget I am shortly presenting to you is bound to be large, the increased revenue from the already greatly increased trade activity throughout the country is giving me much satisfaction, particularly as the amount paid out in unemployment assistance is constantly decreasing and will of course require much less provision in the next budget. This is in spite of the big increase which the emergency legislation made in unemployment benefits. A marked improvement has already been noticed in the appearance of the children due to the improved diets their parents can now afford. The expected surplus of milk, etc., has been a great deal less than was feared due to the increase in purchasing capacity just mentioned. Incidentally many municipalities report they are effecting great savings in public assistance, and will not require all the grants which the emergency legislation made to them to enable them to reduce their rates. They nearly all expect to be able to maintain the reduction in the coming year without further grants, due to the saving on public assistance and the increase in rates from property formerly unoccupied, particularly shops which are now reopening to cater for the increased retail trade. The lowering of the rates has of course been of great assistance to retail traders and has enabled them in many cases to reduce retail prices.

I am already assured by the Bank of England that the £500 million mentioned at the beginning of my

speech will be readily forthcoming, as all the banks have a large surplus of loanable funds due to the steps taken to increase the fiduciary issue in the emergency legislation. No rise in retail prices has taken place although certain wholesale prices have risen. This rise is very welcome to the producers and to me as it augurs well for the income-tax yield in spite of the lower rate of tax.

The arrangement whereby all workers are given one month's holiday during each year on full pay provided by the Exchequer has worked admirably. That great industry, the hotel and boarding-house industry, has of course greatly benefited, it has also greatly assisted our shipping industry, which was able to offer cruises at special rates to large parties and at the request of the shipping companies and from many workers a special extension of time and a special grant was made in instances where workers wished to visit relatives in New Zealand, Australia and Canada, etc. It will, of course, be realised that practically all the money advanced has been spent within the sterling area. The trips being made in our own ships, propelled by our own fuel, manned by our own people and food, etc., provided from Home and Empire sources or from countries which owed us money, but were unable to pay except in goods. Although these measures were of an emergency character they have proved their worth and may become permanent features, although they may be modified to suit changing conditions.

The great work of reconstruction on which we are now embarked will need all our energies and all our



workers, and unemployment should not again raise its ugly head.

The various schemes before the Reconstruction Committee are being sorted out by them, and every endeavour will be made to ensure harmonious working between different schemes and areas. Schemes are in hand for constructing immense reservoirs to collect and retain water during wet periods to avoid floods and to provide water in times of drought. A pure water supply is planned for every town and village throughout the country. All our towns are to be replanned and where necessary rebuilt. All our roads are being replanned as also are our railways. The mines are being dealt with on a national basis, and are being equipped throughout with the finest devices for obtaining the minerals in the most efficient way, both as regards cost and safety to those employed. Our harbours are being also equipped and dealt with in a similar manner. All our resources are being surveyed and are to be developed in the best possible way. The motto is to be efficiency from every point of view. The money devoted to research is to be enormously increased. Special schools are to be built for the purpose of training in research and a national body is to be set up to co-ordinate results and indicate new lines of research. The results will also be communicated to other countries and we expect to have their results in exchange. All our roads throughout the country without exception are to have footpaths provided and wide grass verges wherever possible. It is hoped by this means to greatly improve both the safety and the appearance of our roads.

I will now come to the budget and will report on the means by which the emergency programme was financed and how it is proposed to finance the reconstruction programme.

You will remember it was agreed our aim should be to maintain the average of retail prices at about their present level, but that a special committee should be appointed to examine the position in this respect, and that they should report on the advisability of maintaining this level or whether our object should be to allow retail prices to fall or encourage them to rise. This report may take some time to prepare, but in the meantime, as you are already aware, average prices are practically the same as they were when we took office, and we have had no difficulty in maintaining this level. The greatly increased supplies which had flooded wholesale markets just before we took office were, as you know, taken over and paid for by us. As you also know, these supplies had so depressed prices that trade was demoralised and another great slump and mounting unemployment was already upon us. The situation was saved by our action. The money required to take over the commodities above mentioned was obtained by the issue of Treasury Bills, an addition of course to our floating debt. This method is very economical, as the cost to the Exchequer is less than  $\frac{1}{2}$  per cent. per annum and the money market, which has been so overstocked with loanable funds, was only too pleased to have the opportunity of subscribing for these bills. The first instalment of £100 million was soon oversubscribed and a further £400 million will be issued as required.

No difficulty is expected in obtaining this money as further cash will be placed at the disposal of the joint stock banks in due course. Our currency, although weak when we first took office, due to fears that our policy was inflationary, soon recovered, and we have had difficulty in preventing it rising above its present level. Conditions abroad are not such as to present a haven of refuge for nervous capital, and the steadiness of prices here and the great improvement in our unemployment figures has created such confidence that a great influx of capital has taken place. All Government securities have risen considerably, and I expect a long-dated loan to be issued shortly on the basis of 2 per cent. per annum. It has long been felt, however, that people who own only small amounts of capital should be able to obtain a higher rate of interest and it has accordingly been decided that national savings certificates shall in future be issued to give a yield of 4 per cent. free of tax, with the present limit of 500 certificates per person. This and the rise in old age pensions to £3 per week at age 60 and the rise in sick pay which has been made possible by the grants we have made to the various approved societies should make the lot of our poorer classes a great deal nearer the ideal at which we are aiming.

I can feel many honourable members are wondering how the Budget is going to balance, but those who know more about my ideas in this matter will not expect me to try, at least not to do so in the old orthodox manner. I am quite convinced that all the money we need for all our schemes will be forthcoming. There is not the slightest sign that prices will rise, our

enormous holdings of all the various commodities has placed prices under our control. We are still being offered commodities from all quarters at very favourable prices, and in sterling, our difficulty is to find sufficient storage capacity, but this is being energetically dealt with. It would be very difficult indeed to give the figures of expected revenue and expenditure. On the debit side there is the great rise in the cost of the social services and the enormous contemplated expenditure on our reconstruction programme. On the credit side is the great increase in the tax revenue in spite of lower taxation, due to the big rise in income and profits which has already taken place, and which recent reports indicate is continuing with ever greater momentum. There is the enormous saving already experienced in unemployment pay in spite of the higher rate of allowances, and the many other calls on the Exchequer which were due to under-employment are rapidly diminishing. I much regret the rise in expenditure on our Naval, Military and Air Forces still continues, and I sincerely hope conditions of better trade throughout the world, which I am sure will ensue if other countries follow our example in economic matters, will enable this expenditure to be reduced. There is no fear, however, that this expenditure will cause us to drop our reconstruction programme. Our productive capacity is so enormous and is still so rapidly increasing that ample is available for all requirements. The suggestion that higher unemployment and sick pay will encourage malingering is not borne out by results. It is reported to me that the marked improvement already experienced in the

health of the nation due to better food, and not the least to the feeling of security and hope which better trade and employment brings, has had quite a contrary effect and the claims for sickness benefits are very much reduced and are still falling.

I trust when our next budget is presented that I shall be able to report—no unemployment and no poverty. That is our aim.

If some of the foregoing appears to read like a fairy tale, may I ask if what is there set down is any more of a fairy tale than the recital of the inventions and common everyday occurrences of our modern life would have appeared to an inhabitant of England say only fifty years ago.

It is the changes in production and communication which have quite recently taken place and are still taking place which make the apparent fairy tale possible, indeed imperative.

The expenditure advocated might equal that on the Great War of 1914-18. The results would bear no comparison. But do not forget, none of the money spent would be lost and this country and the world generally would be infinitely better off because of the spending. Why not make a start? How much longer are we to allow outworn ideas to clog our progress? The longer a volcano is choked the greater the eruption when it occurs. The forces created by the inventions of the last few years are striving for an outlet. Is it to be orderly progress? or revolution? or war?

## CHAPTER VIII

### THE GOLD STANDARD

A COUNTRY is on a Gold Standard when it has passed a law making its unit of currency a certain weight of a certain fineness of gold, and its paper currency convertible into gold and vice versa at the agreed weight and fineness. A pound note when we were on the Gold Standard would purchase the same amount of pure gold as 4.866 U.S.A. dollars, 124.21 French francs, 20.43 German marks, 12.107 Dutch florins, etc. These figures are the pound's parity or par of exchange.

All the principal countries had linked their currency to gold in this way and gold is legal currency to any amount in Gold Standard countries. Gold is the only international money.

As a consequence, gold is the only means of settling debts between countries caused by variations in international trade and exchange of services.

*"Free" Gold.*—The amount of "free" gold available in proportion to the total of international trade is very small and therefore the ability of gold to settle the international debts mentioned above is strictly limited.

"Free gold" is the amount of gold a country can part with without upsetting too much the ratio of gold held to its paper currency.

*Gold Ratio to Currency.*—A gold standard country

has to keep a certain ratio of gold to its paper currency in order to ensure as far as possible that its paper money is convertible into gold.

*Duties of a Central Bank.*—The keeping of this ratio is one of the principal functions of a Central Bank. If the balance of trade is against a country, it is the duty of the Central Bank to raise its Bank Rate and, therefore, the rate of interest being paid, in order to persuade its own nationals to retain their money at home or bring money home, and foreigners to leave their money here or remit money to us to obtain the higher interest rate, and so relieve the strain on the exchange. If necessary the Central Bank must reduce the amount of its paper currency and thus enforce a reduction in bank credit, and so force down prices, in order to encourage purchases in its own country and discourage purchases abroad, and so improve the balance of trade.

*Credit and Prices.*—The effect of expansion or contraction of credit on prices of commodities is explained by the quantity theory. This is that total currency and credit at any time tends to equal the total amount of goods and services on offer. Expressed as an equation, it is :

$$\text{Currency} + \text{Credit} = \text{Goods} \times \text{Prices.}$$

If currency and credit are reduced and goods remain the same in quantity, prices must fall and vice versa.

Assume currency + credit were £1,000, and goods 1,000 units at £1 each. Then if currency and credit are reduced by 10 per cent. and the amount of goods remains the same, prices must be reduced 10 per cent.

Currency and credit would be £900, and the average price of goods units would be forced down to 18s.

*Ratio of Cash to Deposits.*—The ordinary banks in a country can create bank credit or deposits according to the amount of cash they have on hand or on deposit with the Central Bank. The amount of credit thus created in England is about nine times the cash holding. Thus paper money and bank deposits are linked with gold whilst on a Gold Standard.

The balance sheet below is a composite statement in round figures of 41 banks of Great Britain and Ireland as on December 31, 1930 :

(000's omitted)

LIABILITIES.		ASSETS.		
	£		£	£
Capital and Reserves .	199,000	Cash		393,000
Profits . . .	11,500	Loans :—		
Notes in circulation .	30,000	Lent on Short Term .	179,000	
Deposits . . .	2,506,500	Investments	568,000	
		Bills discounted .	350,000	
		To Customers	1,206,000	
		Bank Premises		2,303,000
				51,000
	£ 2,747,000			£ 2,747,000

It will be observed that capital and deposits are practically balanced by cash and loans.

An investment is as much a loan as either of the other types shown. Bills discounted are loans on security of bills. The cash shown is more than one-



tenth of deposits, as it is the custom of some banks before preparing their balance sheet for December 31 to call in part of their short-term loans.

The borrowers obtain the funds for repayment by borrowing from the Bank of England. The amount borrowed is placed to the credit of the banks in the Bank of England and consequently swells the item "cash in hand or at Bank of England." The item "short-term loans" is correspondingly reduced. The short-term advances are again made after the date of the balance sheet and the ratio of cash to deposits is again restored to about 10 per cent. This ratio for the London Clearing Banks during 1929 varied between 10.5 in February to 11.3 in December and in 1930 between 10.5 in February and 11.1 in December.

If the amount of gold held by the Central Bank increases, Bank Rate should be reduced, currency and credit increased and lendings abroad encouraged, the reverse to take place if gold holdings decrease.

An increase in gold holdings, therefore, has an inflationary tendency, and a decrease has a deflationary tendency.

The amount of gold held in a Gold Standard country has certain definite effects on:—

The amount of its currency and bank deposits.

The level of internal prices.

The balance of trade.

*Creation of Bank Credit.*—Every time a bank makes an advance a deposit is created, and every time an advance is repaid a deposit is cancelled. If, then, owing to a loss of gold a Central Bank decreases the amount of cash issued, and thus the cash holdings of

the other banks, these banks restrict loans in order to reduce deposits and so maintain their ratio of about 10 times their cash balance. As bank loans are used to finance trade and purchases of Stock Exchange securities, the working of the Gold Standard has a definite effect on trade and Stock Exchange prices.

On a Gold Standard the amount of credit available is strictly limited and is governed by the gold holding of the Central Bank. Consequently, if trade is good and is tending to use an increasing amount of credit and the demand for currency for wage payments and cash purchases is also increasing as a cause and effect of good trade, a strain is thrown on the ordinary banks to find the additional credit required, and at the same time maintain their ratio of deposits to cash holdings. The Central Bank also finds difficulty in meeting the demands for currency and at the same time maintain its ratio of currency to gold and so the convertibility of currency into gold.

If the supply of gold was increasing at the same rate as production, credits could be increased in the same proportion. But gold production has not so increased, and the almost universal tendency to hoard gold reduces the amount available as a basis for credit.

If prices are to remain stable, a steadily increasing amount of gold will be required to finance trade, as world production is increasing. Inability to increase credit and currency due to shortage of gold is the reason for alternate booms and slumps or, as it is called, the trade cycle.

*Use of Cheques.*—The cheque system economises the use of currency to a very great extent. This system

is most in use in Great Britain and we have, therefore, been able to finance a very large trade with a very small gold holding.

*Gold Standard Summarised.*—The advantages of a Gold Standard, according to its advocates, are :

1. Stability of foreign exchange rates.
2. Inflation of currency is prevented.
3. Automatic indication of balance of trade is provided.

Its disadvantages are :

1. Inability to meet increased demands for financing increased trade, thus causing the trade cycle.
2. Its persistent deflationary effect.
3. The liability for gold to be hoarded by a country with a favourable balance of payments instead of the balance being lent to foreigners on long term. This throws the whole system out of gear and strangles trade.
4. Production is subjected to alternate expansion and contraction, this adds very considerably to production costs.
5. It tends to make employment irregular and creates unemployment.
6. It restricts distribution of production, as sufficient credits cannot be created to enable production to be purchased and consumed.

#### THE SUSPENSION OF THE GOLD STANDARD

Although increase in production and productive capacity contributed to the fall in commodity prices, it was not the main reason. The main reason for the

fall was the hoarding of gold in France and U.S.A. They were enabled to do this as reparation and war-debt payments gave them a favourable balance of international payments which they refused to take in goods or to end on long term.

In effect, they "cornered" gold and so forced up its value. As its price in countries on a Gold Standard is fixed and all commodities are priced in terms of gold, prices were forced down.

If one ounce of gold bought 100 units of goods, then as the price of one ounce of gold when we were on the Gold Standard was 85s., these units would be bought for 85s. If the value of gold is forced up by 20 per cent. an ounce would then purchase 120 units of goods.

Consequently, as the price of gold was fixed, 120 units could be purchased for 85s. and the price of each unit was forced down.

*Reasons why Suspended.*—Great Britain was compelled to suspend the Gold Standard because the total of payments coming to her was less than the total being paid out. The reasons for this were as follows :

Overlending, due largely to financing reparation payments.

Freezing of credits abroad, particularly in Germany and Austria, also due to reparation payments.

Drop in value of primary commodities. This is a very important factor, but was also largely due to reparations and war-debts payments.

The drop in value of commodities caused a serious loss of income in several ways :

Most of our debtors abroad depend on sales of

primary products to enable them to obtain exchange with which to pay interest on external debt. Some were compelled to suspend payments and all were compelled to restrict imports, so we lost in two ways. A direct loss of income from interest and a loss of credits from sales abroad.

Some equity investments suspended dividends, partly because all equity investments suffer when prices fall, and partly owing to exchange losses, as in Argentine Railways, in which we are very largely interested.

We have in the past received large sums from our investments in rubber and tin and in payments to English nationals managing these concerns. The U.S.A. is by far the largest consumer of these commodities and our credit from their sale fell very severely indeed.

Insurance premiums fell heavily, due to lower value of cargoes.

Shipping receipts were lower owing to less trade.

Banking commissions fell as a much smaller amount of money was required to finance commodities on a lower price basis and total trade was also much smaller.

The only set-off against the above adverse factors was a drop in the cost of our raw materials, but this was quite insufficient. Other adverse factors were due to our position as international bankers. Other countries were also feeling the strain and withdrew deposits to strengthen their own position. In addition, for political purposes, some of our most important newspapers carried on a campaign against the pound—although they said it was of vital importance for us to remain on the Gold Standard. This campaign,

naturally, added to nervousness abroad and materially contributed to the fall of the pound. See also page 27.

*Effects of the Suspension.*—Holders of our currency who wish to buy foreign currency are now unable to obtain gold from the Bank of England at the statutory price of 85s. per ounce. They must, therefore, buy gold in the open market or accept the amount in foreign currency which a holder is willing to give for pounds. The rate of exchange is consequently bound to fluctuate considerably unless the authorities are able to stabilise the rate or as it is called, “peg the exchange.”

On a Gold Standard the direction of the flow of gold indicates whether the balance of international payments is in our favour or not. Without a Gold Standard the rate of exchange serves this purpose and at the same time assists to stabilise the position. A fall in the value of the pound would indicate the balance of payments is against us, but would stimulate exports and restrict imports.

See also Chapter IV page 27.

#### A BOOM IN GOLD PRODUCTION ?

A new factor has now begun to show signs of coming into effect, and this is the possibility of a very large increase in gold production. Owing to a shortage of gold caused mainly by hoarding in U.S.A. and France, but also elsewhere, the value of gold as expressed in commodities was forced up. This meant that prices of commodities were forced down when the price of gold was fixed, but when the pressure on commodity producers became too great the price of gold was

raised. In other words the pressure was released from commodity prices and transferred to the price of gold which rose from 85s. to about 140s. per ounce. This had much the same effect as regards the basis of credit as an immense increase in the supply of gold. It had also the effect of making the production of gold much more profitable. The natural result in a world of limitless possibilities of production is that now that sufficient time has elapsed to enable modern methods of mass production to get into their stride, the supply of gold shows signs of being rapidly increased. How rapidly is not clear at the present, the supply from South Africa has only increased slightly owing to their policy of lowering the grade of ore treated, but according to recent reports Russia has now become the largest world producer, and if she decides to export gold in large quantities it may have far-reaching consequences. If U.S.A. is willing to take it and sterilise it, all will be well for a time. She will then be able to export without being compelled to take goods in exchange. She may, however, find difficulty in sterilising the gold if the supply is very plentiful, and if it becomes a basis for credit, prices in U.S.A. will rise rapidly and a boom may result. If the U.S.A. authorities wish to avoid this they would naturally be tempted to lower the price of gold as expressed in dollars. But they could not do this without our consent and that of France, unless they were willing to break the Tripartite agreement. This in effect is that U.S.A., France and ourselves agree to maintain the exchange value of the respective currencies at about the rates when the agreement was made. Neither France nor ourselves

are at present overburdened with a huge gold holding. France is anxious to regain some of the gold lost during the past few years owing to political fears, and we have to consider the effect on Empire gold producers quite apart from the loss occasioned to our Exchange Equalisation Fund if it has to lower the value of its gold holding. If U.S.A. lowered the price of gold, and we and France maintained it at the present level of about £7 per ounce, the value of the dollar would rise in terms of pounds and francs, and all the currencies in the sterling area. That is the dollar rate would fall as it did when we suspended the Gold Standard and although the fall would only be to the extent of the amount by which the gold price was reduced, the U.S.A. has a lively recollection of the effect of the last fall in the dollar rate, and does not appear to wish it repeated. This is apart from her obvious desire to work in co-operation and maintain the agreement with us and France.

The lowering of the price of gold would, of course, have an adverse effect on the quotations of gold-mining shares, whilst if the price is maintained and the supply is largely increased, the prices of all other commodities would be forced to rise. This would have the effect of increasing the cost of producing gold, but this might not for some time have the effect of restricting gold production, as efforts would be made to maintain profits by raising the grade of ore treated, and this would increase the actual output of gold. This is quite apart from the number of other gold-mines in South Africa and elsewhere which will shortly reach the production stage. An immense amount of work and ex-



penditure is needed to bring a modern gold-mine into operation, but the output is correspondingly large when production is started.

It should be noted that increased gold production would not have the same effect as an expansion of credit made to keep pace with production. No attempt is being made to regulate gold production to other production, and a sudden supply of gold which may come from any quarter of the world might be quite outside our control. If we are on any form of Gold Standard we have not full control of our monetary policy. This was not so important in the past, but with modern possibilities of gold production we may have to contend with a sudden immense increase in supply with quite incalculable consequences. If, on the other hand, we are compelled to regulate gold production to keep pace with our other production, surely it is only one step more to do away with gold altogether, as it would be far easier to control the output of our own currency than of a commodity that is found in so many parts of the world. The amount of labour that is at present engaged directly and indirectly in the production of gold is very large indeed. Another outlet may have to be found for it, but that is only another argument for the thesis of this book that the problem of production, even of gold, has been solved, and we must now take control, whether we like it or not. The time may not yet be quite ripe for a regulation of gold production, and of its price. It would certainly be a revolutionary step, but it is a possibility which cannot be ignored. It is probable that for some time it will be possible to sterilise gold

## THE GOLD STANDARD

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holdings and to allow it to become a basis of credit only as required by increasing production of other things. This may well be good training for full control without the use of gold.

## CHAPTER IX

### THE BALANCE OF TRADE

A COUNTRY'S balance of international payments, or as it is popularly called, the balance of trade, is made up as follows :

DEBITS.	CREDITS.
<p>Purchases Abroad, i.e. Imports.</p> <p>*Payments for services by foreigners, such as :</p> <p style="padding-left: 20px;">Shipping.</p> <p style="padding-left: 20px;">Insurance.</p> <p style="padding-left: 20px;">Banking.</p> <p>*Interest paid to foreigners on loans made by them.</p> <p>*Loans to foreigners.</p> <p>*Expenditure of tourists abroad.</p> <p>*Remittances to nationals abroad.</p>	<p>Sales Abroad, i.e. Exports.</p> <p>*Receipts for services rendered to foreigners (as on debit side).</p> <p>*Interest received on loans to foreigners.</p> <p>*Borrowings from abroad.</p> <p>*Expenditure of foreign visitors.</p> <p>*Remittances from nationals abroad.</p>

In theory the balance to be adjusted by a gold shipment.

The debit items starred are termed invisible imports, and the credit items starred are called invisible exports, as they do not appear in the returns of imports and exports of goods.

A country is said to have a favourable balance of trade when its credits abroad exceed its debits, an adverse balance of trade where its debits abroad exceed its credits.

Invisible imports and exports are an important part of the balance of trade. It is extremely difficult to estimate, with any degree of accuracy, the amount of these items. Great care is, therefore, necessary before any action is taken because of an apparent favourable or adverse balance of trade. The Government by means of the Exchange Equalisation Fund are able to ascertain the trend of the balance to a certain extent, but many factors, very difficult to estimate, are continually affecting the position.

Great Britain always has an apparent adverse balance of trade, that is the total of our imports is always larger than our exports. It has been many times suggested that this means we are buying too much abroad, and great alarm has often been expressed when exports declined and imports rose. Much international friction has been created by comparing imports and exports between us and our colonies, and between us and various foreign countries. Similar comparisons are made by foreign countries between themselves and us, and between themselves and other countries. The whole subject bristles with difficulties, but a few observations will show how absurd are the usual conclusions which are drawn from these comparisons.

In our own case, we have prohibited foreign loans because the balance of trade appeared to be against us. It was said we could not afford to lend money as we were buying too much abroad, and not selling

enough. But the effect of stopping loans abroad makes it impossible to sell abroad to anything like the amount we could do if the loans were continued. If we had lent enough we could have so developed our export trade that our exports could have shown a value even greater than our imports. Should we then have been delighted? If, however, our loans abroad were repaid to us by the only means it is possible to pay us, by goods and services, or if the loans abroad had been in the form of investments in, say, Railway Ordinary Stocks, or in mining shares, then if very large profits were made abroad and big dividends were declared, the goods sent to us in payment would come to us as imports, and thus our adverse balance as shown by the figures of imports and exports would be very greatly increased. But if the investments abroad were a failure, or if our foreign debtors defaulted on the loans we made to them, then no goods would come in and our exports would be more than imports and a favourable balance would be shown. Could anything be more absurd? Our refusal to lend abroad made it impossible for many of our foreign debtors to pay us the interest on the money we had lent them. The magnificent railways, which were built by British capital in Argentina and are still owned and controlled by British capital, are unable to pay a dividend on a very large proportion of the capital invested because we have restricted lending to Argentina. Our export trade in the past has been largely built up on our willingness to lend abroad. On balance we have sent no money abroad, we have merely sent our goods and services. We can only be paid back in the same

way, by goods or services, and our investors in foreign loans will not get their interest or their money back unless we admit goods. When foreign countries borrowed money here from our investors, the money was used to pay wages, taxes and interest, profits, etc., to our workmen, our Government, our manufacturers and our investors. In other words to pay for our goods, the cost of which included all the above payments. Whilst we were on a Gold Standard there was a danger that a loan obtained here might be taken out in gold, and thus upset our whole financial system. But that is surely an argument against the Gold Standard as quite a small loss of gold was a very serious matter. Under the present system if a borrower here does not wish to take our goods he has to sell the pounds he has borrowed in order to obtain the other currency he requires, and the sale may involve him in serious loss if sufficient of the needed currency is not on sale. His endeavours to sell pounds might depreciate our foreign exchange.

A depreciated exchange might be of great benefit to us, but if we did not wish our currency to be depreciated we could very largely avoid it by only allowing loans to countries who are willing to take our goods. It must be remembered it is highly improbable that our foreign loans will ever be repaid to us, except in the event of our being at war, but as we have a large surplus manufacturing capacity, which is organised for the production of goods for export, we might just as well keep it at work and export the goods as let the machinery and men be idle and deteriorate. The main reason we have an apparent adverse balance of

trade is because we are a creditor nation. We achieved this position as we were the first nation to experience the industrial revolution, and for a number of years we exported large quantities of goods. Raw materials were imported in part payment, but we constantly made loans and invested abroad, as a large surplus remained in our favour, and a very large proportion of our exports were paid for by loans and investments made by our investors. The interest on the loans and the dividends on the investments were often reinvested abroad, and our total foreign investments before the Great War amounted to a very large sum indeed. A considerable amount was realised to pay for war materials during the War, but a very considerable amount still remains. Our imports include many items which do not require exports to be sent out to pay for them. For instance, if a company is formed in England to mine tin in say Malaya, or Nigeria, almost the only cost to us to obtain the tin is the cost of purchasing the land and that is often very small. Most of the machinery required to obtain the tin would be purchased in England, and would go out as an export. The cost and profits of floating the company would remain in Great Britain. Directors and officials would be employed and paid in Great Britain from the proceeds of sales of tin in Great Britain or say U.S.A. A British mine manager and British assistants would most probably be employed and would, of course, arrange for part of their salaries to be paid by the company to their families in Great Britain, or placed to their credit in a British bank. They would probably go out to the mine in a British

ship, as also would the machinery. The total value of the tin imported would be included in our imports, as also would the value of goods sent to us by other countries in payment of tin sold to them. The cost of the native labour which is required to obtain the tin is quite small. The value of the tin produced is, therefore, in our total of imports, the amount we must export to obtain the tin is very small, the balance comprised of the items mentioned above are invisible exports, that is they are not entered as exports in the balance of trade, but they nevertheless pay for the tin. Similar conditions exist in respect of tea and rubber, and many other imports, so why should we be anxious when our imports increase? The only thing we need worry about is to ensure we are able to obtain the raw materials we need from abroad, and there is no evidence that we are in any danger of that. Quite the reverse, we have been compelled to put restrictions on the import of goods of all kinds from abroad, and to restrict production of tin, tea and rubber to avoid our markets being flooded with such things. Nearly all the countries which supply us with raw materials are heavily in debt to us, and many are unable to pay the interest on their loans from us or dividends on money invested by us in their country because we do not take sufficient of their raw materials.

If we lend them more they could pay us the interest with the money we lend them, and could buy more from us. They would owe us more of course, but our exports cost us nothing but our labour, of which we have millions unemployed, and in the event of war the amount they owe us might be of incalculable value.



The following is an extract from *The Times* of May 18, 1936:

“Notable remarks on the broader economic implications of foreign lending were made by the chairman (Mr. Maxtone Graham) at the recent meeting of the Scottish Mortgage and Trust Company. He criticized the tendency on the part of some persons to regard British investment abroad as deserving little consideration from the Government and Parliament, and as being almost harmful to the country's industrial interests. Unquestionably oversea investments constitute a very valuable part of this country's economy, and without them the standard of living in this country would be lower than it is to-day. They yield to-day an income estimated at approximately £200,000,000, which means that essential foodstuffs and raw materials can be imported without corresponding exports having to be made to pay for them. Oversea investments result from exports made in bygone years, which were not paid for at the time by imports. It would be more difficult to make the exports now for two reasons—namely, the virtual suspension of international finance by creditor countries and the higher standard of living and the higher costs of production which prevail to-day compared with production costs in countries with a lower standard of living.

#### CONDITIONS OF RESUMPTION

It is because the income from oversea investments not only plays an important part in balancing the nation's annual balance-sheet, but also makes possible the present standard of living, that thoughtful persons are anxious to see a resumption of international lending and the consequent stimulation of our export trade. Without a resumption of international financing it is going to be difficult in the long run to increase the standard of living in this country or to find employment in those depressed areas which are depressed largely owing to the contraction of international trade. Mr. Graham has rendered useful ser-

vice in calling attention to this important problem. Foreign countries, he explained, would not be able to purchase capital goods in Great Britain unless they could also borrow in Great Britain the means with which to pay for them in the first instance. The resumption of international lending involves, of course, the settlement of the defaults on old loans, and some further progress with the problem of currency stabilization."

The importance of our foreign investments is rightly emphasised, but the comments on the speech state that it is now more difficult to make exports for two reasons, namely, the virtual suspension of international finance by creditor countries, and the higher standard of living and the higher costs of production which prevail to-day, compared with production costs in countries with a lower standard of living. The comments also state that the resumption of international lending involves the settlement of defaults on old loans and further progress in currency stabilisation. But debtor countries have defaulted because creditor nations have suspended international finance (in other words creditor nations have stopped lending), and because creditor nations have restricted imports from debtor countries, which is the only way debtor countries can pay. Creditor nations must both lend and import, then the defaulters will be able to pay and not before, and exchanges will also be much more likely to be stabilised.

The comment regarding higher costs of production here compared with other countries is also quite beside the point, as the countries with a lower standard of living cannot buy so much because of their lower standard of living, and as they cannot buy neither can they sell unless they also are willing to export on loan.

## CHAPTER X

### THE NATIONAL DEBT

It is commonly stated and commonly assumed the National Debt is a burden, and that it would be greatly to our advantage if it was substantially reduced or even repaid. But the National Debt plays a very important and useful part in our financial machine. One of the main reasons why the banks in U.S.A. were compelled to close during the financial crises of March 1933 was that a very substantial part of the U.S.A. National Debt was repaid during the boom period of a few years before, when large budget surpluses were common. The result of these repayments of Government debt was that the banks and individuals found themselves with large amounts of cash which they were unable to reinvest in Government securities, and were consequently almost compelled to invest in mortgages on land and house property, railways, etc., and very large sums were also made available to finance Stock Exchange speculation. As a result the prices of house and land were pushed up, farmers were encouraged to buy farm machinery, etc., with money borrowed on the security of their farms, and the prices of Stock Exchange securities rose to unprecedented heights. When the crash came, instead of banks and insurance companies having Government securities for

sale, for which there is always a market and for which in the long run the Government would be compelled to find money to repay, they found themselves with assets they could not realise. In many cases farmers organised armed resistance when an attempt was made to foreclose on their mortgages. The endeavours to sell land and buildings caused very serious falls in their value, and the banks and insurance companies found the value of their security forced down below the amount of their advances.

An examination of the Balance Sheet of our banks will show what a large proportion of the deposits are secured by the National Debt.

The first line of defence of the banks in the event of a sudden increased demand on them for money is almost entirely short-dated Government securities. The other investments of the banks are almost entirely Government securities, and a substantial part of their advances to customers are secured by Government securities, what better security could be found? A large part of bank deposits are, therefore, National Debt, once removed, and the deposits would not be there if the National Debt did not exist. Bank deposits are also a valuable reserve of spending power to individuals. Insurance companies and pension funds, etc., invest largely in National Debt. If there was no National Debt in what would the careful thrifty man or woman invest his or her savings? There is nothing so safe as the National Debt, except British bank deposits, but if there was no National Debt or it was considerably reduced in what would the banker invest the deposits put in his care? He cannot do better

than invest in the National Debt, and this is accordingly what he usually does. A substantial repayment of National Debt would, therefore, compel a rise in the price of the National Debt which remained, and might cause an unhealthy rise in the values of land, buildings and Stock Exchange securities. In fact, the National Debt is not a burden, it is almost entirely owed by ourselves to ourselves, and the interest is merely a transfer from one pocket in the community to another. It does, however, provide for individuals an extremely valuable reserve of purchasing power in case of need, and an almost indispensable channel for saving. It is well known that at times serious depreciation has taken place in the value of Government securities, but this would be easily avoided if the Government only issued securities which were definitely redeemable at par at the end of a definite number of years. The reason why securities are issued which are only redeemable at the option of the Government, like Consols  $2\frac{1}{2}$  per cent. and War Loan  $3\frac{1}{2}$  per cent. and Conversion  $3\frac{1}{2}$  per cent., is that if a policy of deflation is decided on, and in consequence money is scarce and dear, the owners of the above-mentioned securities would be deterred from selling them as the prices of the securities would have a severe fall. If on the other hand the securities were redeemable at par at a fixed date, the fall in prices would be less. The least fall being in those securities which were nearest to redemption date, the longer the period to date of redemption the larger the fall in the value. Consequently the owners of short-dated securities could always obtain cash for them with only a very small

loss, if any. The ability to obtain cash in this way would provide a severe check to a policy of deflation, and the large proportion of the National Debt which is in the form of securities only redeemable at the option of the Government, provides eloquent testimony to the anxiety of the authorities to be able to deflate when they wish to do so. The existence of a large floating debt may compel inflation, and if inflation is considered a menace it is natural that the authorities should endeavour to reduce the floating debt. The conversion of floating debt to long-term debt is called a "funding" operation, and is definitely a step towards deflation or the avoidance of inflation. The adoption of a dear-money policy by the Government makes certain a fall in the prices of long-dated Government securities. Just as certainly a cheap-money policy means high prices for long-dated Government securities. The Government can decide their own policy whilst we are not on a Gold Standard, but have not this power if we are on a Gold Standard.

#### BALANCING THE BUDGET

This is also only another pretext for instituting deflation. What does it really mean? On one side of the Budget is the Nation's Expenditure and on the other side is the Income or Revenue, but do not forget that the income side represents payments by taxpayers and the bigger the income the bigger the amount collected in taxes. On the expenditure side is the amount which is given back to the nation, such as interest on Government Securities, payments to the Army, Navy and Air Force, and the suppliers

of their needs, the salaries of Civil Servants, Old Age Pensions, Education, contributions towards unemployment pay, National Health Insurance, etc.

If an individual's expenditure exceeds his income for a long enough time, he will go bankrupt, but you cannot make the Government bankrupt whilst it has power to issue legal currency. In effect the Budget is merely an account of how much the Chancellor of the Exchequer has taken from one set of pockets and how much he has put into another set of pockets. In doing so he performs an essential service for he has enabled the nation to do many necessary tasks collectively, which could not possibly be done individually.

If a large mass of unemployed exists it indicates a lack of purchasing capacity in the hands at least of one section of the community, must a Government wait until a sufficient quantity of gold has been dug up from somewhere or other before providing the necessary purchasing power? One section of the community may have an excess of purchasing capacity, but that does not always mean they want to spend it or even to invest it. They may want to keep it just in case of need and why not? It serves if it only stands and waits, but must the unemployed stand idle until its owners choose to act? If purchasing capacity is required must the Government be compelled to take it in taxation and so deprive someone of purchasing capacity, who would possibly have spent it at least as well as the Government. That is merely transferring purchasing capacity, it might be that the Government would take it from someone

who otherwise would not have spent it and that would be of assistance in providing employment, but the persistence of unemployment is itself an indication that it is not the transfer of purchasing capacity but the creation of purchasing capacity that is required, and who better than the Government should have this power. In fact the Budget should only balance when there is no unemployment. The creation of credit is, of course, called inflation in orthodox circles, but a dose of inflation is absolutely essential if there is insufficient purchasing capacity available, and it cannot be obtained in other ways.

If production is increasing and prices are reasonably stable, balancing the Budget is a fetish and nothing else.

There is one interesting sidelight on the very strong instinctive desire of practically all Chancellors of the Exchequer and practically all Bankers to impose deflation and avoid inflation. That is, that our cheque system, which is a corner stone of British Banking, and without which the Joint Stock Banks could not exist, came into being from the absolute necessity of trade to find some means of obtaining more credit and a way of making a small amount of money go a very long way. The cheque system itself enables a form of inflation to take place. It is this system which enables the Joint Stock Banks to create deposits and only maintain £1 in cash against every £10 of deposits. A perfectly safe and extremely useful function, but it is inflation nevertheless, in the sense that the word "inflation" is generally used.

The National Debt is not a burden, but is a valuable



part of our money machine. The question of a burden only arises when the taxation to provide the interest is not equitably assessed. There is a limit to the amount of National Debt which should be issued, but if the productive capacity of a country is in a healthy state, the total of our National Debt could be very substantially increased with great advantage to everybody. Particularly if the additional money borrowed was spent by the Government in developing and improving our national resources and productive capacity, and if the ownership of the securities composing the National Debt was more evenly distributed throughout the various classes of the population.

It is often stated that if we issue loans we are making posterity pay instead of paying ourselves. This is a particularly absurd statement, but it has often been used by Chancellors of the Exchequer as a reason for increasing taxation instead of obtaining a loan. What part of posterity will be made to pay? Surely not that which will own sufficient Government securities to enable them to live comfortably on the income derived from their holding. If the ownership of the securities composing the National Debt was evenly distributed throughout the population, and taxation was equitable, who would be bearing the burden? We can only make posterity pay if we squander our material, not our money resources, or restrict efficient development or spoil our assets either in men or material. If we do this the result is the same whether we pay cash or borrow from another part of the community. If on the other hand we carefully develop and increase our resources, whether

again we pay cash at the time or borrow from another part of the community does not matter, what really matters is in what condition we hand on our country to our children, and whether we have made sure they have been properly fed, clothed, housed and educated. To refuse to feed or clothe, or house a part of our population when plenty is available or can be produced, is surely the height of folly and in that way we can make posterity pay.

## CHAPTER XI

### MONEY AND WAR

It is often stated that war costs enormous sums of money, but whilst it is of course true that immense sums of money are paid out during a war, it must not be assumed that these sums are entirely lost to the country making the payments.

A modern war is a period of intense industrial activity, without it modern warfare cannot be carried on. The value of all production during the last year of the Great War, including the value of the war material produced, was by far the greatest in any year either before or since. The payment for the intense industrial activity naturally called for the expenditure of vast sums of money, and this money would not have been forthcoming if the nations engaged had kept strictly to the pre-War Gold Standard. Almost the first thing that was done by us on the outbreak of the War was to suspend the Gold Standard. We should soon have been completely defeated if we had refused to expand our currency and our bank credit in order to pay the Army, Navy and Air Force and for the enormous quantities of goods of every description which were required. Our gold reserve was very small, and if we had been compelled to rely on that to purchase from abroad the things we needed we should

soon have been compelled to admit defeat. We had, however, large investments in most of the countries which supplied us with materials, and we were able to sell these investments at very good prices to the people of these countries in exchange for the things they sent us. The amount thus provided, although large, was only a small fraction of the total cost of the War. By far the greater amount of the cost represented payments by ourselves to ourselves, the money remained in the country, and was either invested in the various War Loans or left on deposit in the banks. The figures of bank deposits, etc., given on page 3 illustrate this point.

During the War the Government first drew as required on the Bank of England, and printed notes also as required. The payments by the Government inevitably found their way first into the Joint Stock Banks and the Savings Banks, and these funds were partly used by the banks to subscribe for Treasury Bills, which are only for short periods, and for other Government Loans which are for longer periods. Customers of the banks also subscribed for Treasury Bills and War Loans, but mainly the latter. The money so subscribed was paid into the Bank of England and was again available for drawing by the Government. These subscriptions were never sufficient to meet the colossal demands of the Government for money during the War and for a year or two after the War. It was continually necessary to increase the issue of Treasury Notes and Treasury Bills. Treasury Bills being for short terms only, are called the "floating debt." They were very popular with the banks and

financial houses, as they were a very profitable method of lending to the Government, and there was no risk of capital depreciation as there was in subscribing for long-dated issues like the War Loan, and practically no danger of overlending and being caught short of ready money as the short-dated Treasury Bills could always be discounted at slightly less than nominal value, or held a short time until the due date when cash was paid out against them by the Bank of England on behalf of the Government. The floating debt reached huge proportions, and owing to the ability of holders to obtain money for them at short notice, there was always a possibility of the Government being compelled at short notice to increase the issue of Treasury Notes in order to find the necessary cash. This has an inflationary effect, and it was, therefore, necessary when deflation was decided on for the floating debt to be substantially reduced. This was done partly by pushing the sale of the longer-dated loans, and partly by using the proceeds of the sale of surplus war material to pay off Treasury Bills. These proceeds amounted to nearly £1,000 million and were a very important factor in making deflation effective in 1921-2 and in causing the first post-War slump. The rise in the cash holdings of the banks during and just after the War was due to the above-described method of financing the War. Increased deposits followed as a result of the increased note issue, and the constantly increasing loans to the Government. (See chapter on the "Gold Standard.")

The issue by the Government of long-dated Government securities is called a funding operation. The

larger the proportion of the National Debt which is in this form, the greater is the power of the Government to enforce deflation if it wishes to do so. A higher rate of interest is offered on longer-dated loans, and on securities only redeemable at the option of the Government, as an inducement to subscribe to these forms of securities.

It is stated that Germany spent £1,500 million on rearmament in the first three years of the Nazi regime. This is very misleading as they did not spend pounds but marks, they did not possess anything like that amount in pounds or gold. It is also stated that, owing to the enormous expenditure on armaments, Germany is in serious danger of a financial crisis, and again, owing to the enormous outlay required, that Germany must reduce her rearmament activity and could not afford to start or carry on a war for any length of time. This is quite wrong, as to the extent that Germany is self-supporting, any money required would be German money and, therefore, be provided by Germany. It would merely circulate in Germany and would not diminish or be used up. Germany can continue arming just so long as her people are willing to work in making armaments, provided she can obtain such essential materials from abroad as are required. If her scientists could find means to produce in Germany all that she needed she would require only German money to continue arming or to carry on a war. In the meantime, as raw-material producing countries are in great need of a market for their produce, Germany is in a strong position as regards obtaining these raw materials as she can barter her manufactures

for them. Of course, if the raw materials were used to increase the standard of living of the German people, instead of her armaments, the standard would soon be much higher than at present, and prosperity would be achieved without colonies. It is not lack of money that stops war or armaments in a highly organised modern state such as Germany, and if Germany can find means by utilisation of the discoveries of modern science to make herself self-sufficient and independent of imported raw materials she would be in a far stronger position in many ways in the event of a war than was the case in 1914-18.

## CHAPTER XII

### REARMAMENT

SINCE the previous part of this book was written, two very important financial events have occurred. One is the Tripartite agreement, and the other the decision to rearm.

The former is an agreement between Great Britain, France and U.S.A. to assist each other in maintaining their currencies at the rates of exchange existing at the time of signature.

It is pointed out earlier in this book that if we agreed to do any such thing we at once lost full control of our financial policy. It is very significant that very shortly after the agreement a severe setback has occurred in the prices of Government securities, and of all fixed interest securities. It is true that the fall coincided with the announcement that the Government proposed to borrow £400 million for defence, but if the Government had been prepared to allow the exchange value of the pound to fall, they could have supported the market and also have arranged for the banks to do so. The fall in the exchange value of the pound could not have gone very far, as apart from the fact that a very large part of our requirements is obtained from within the sterling area, the U.S.A. are obviously determined that sterling shall not



depreciate for fear of its effect on the prices of their own export products and on their competitive power abroad. Also, because they are already very concerned at the enormous amount of foreign money that is now deposited in U.S.A., so-called "hot money," as it is liable to be withdrawn suddenly at any time and thus cause financial embarrassment in U.S.A. To what other country would nervous people send their money? It would have considerably enhanced our prestige if the announcement of the defence loan had not caused a fall in Government securities, and the consequent revival of confidence would have soon persuaded any nervous sellers to repurchase the securities they had sold. If, however, we have agreed to protect our exchange it appears we still cling to the practice of the Gold Standard period, that is of making interest rates higher here in order to attract foreign investments, and to persuade our own holders of money to retain it here. I would suggest this is a very mistaken policy; surely nothing is more likely to shake confidence in Government securities than to allow prices to fall, and the fall itself is certain to cause further nervousness and to add to the money which has already sought a refuge in U.S.A. The fact remains that the Government can maintain gilt-edged prices if they wish to do so, but as pointed out previously in this book the Government and its advisers seem very anxious to have the ability to deflate when they wish to do so, and that the very large proportion of the National Debt which is in the form of securities which are only redeemable at the option of the Government, not at the option of the holder, assists them if

they wish to deflate. It must be remembered that War Loan 3½ per cent. stock, which is a large proportion of our National Debt, was previously War Loan 5 per cent. 1929-47, and as such had to be redeemed by the Government at par not later than December 1, 1947. War Loan 3½ per cent. is only redeemable at the option of the Government, and if it is decided to raise interest rates a substantial fall is inevitable in the price of this stock. A large part of the people who invest in Government securities do so to obtain safety of capital as well as of income, and if the Government is prepared to increase interest rates War 3½ per cent. stock is not a suitable investment for safety of capital.

The effect of the heavy spending on such entirely unproductive things as arms is bound to be shown at first in a rise in commodity prices. The effect of the enormous increase in productive capacity will be obscured by this sterilisation of a large part of the products, nevertheless even this cannot entirely obscure the increase in productive capacity, and when production really gets into its stride, a fall in commodity prices is certain, in spite of the effect of rearmament, except the amount to be spent is far greater than is at present contemplated.

If we arrive at a stage when we decide that we are satisfied with our preparations, and if our expenditure on arms is not immediately substituted by expenditure in other directions, such as reconstruction on an immense scale, the fall in commodity prices will be far more sudden and severe than it was in the slump of 1930. We should make preparations now in order

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that spending can be switched over at once to other and better ways, immediately an opportunity occurs.

If, as suggested earlier in this book, we had continued production during the depression and stored large quantities of surplus raw materials, the sudden demand for rearmament would not have caused a violent rise in prices. Industry generally would have been able to produce on a more regular and therefore more profitable basis, and we should have avoided the danger of forcing production to a far higher level than is normally necessary. Our present methods first make a slump and then create a boom with the inevitable slump to follow. The method recommended in this book would not only stop a slump, it would also stop a boom. This does not mean that production should be on a moderate basis, the actual production over a period would be a great deal higher than at present, but it would proceed steadily and scientifically, and not in a series of sudden halts and hectic rushes.

Again, if rearmament is scientifically managed, it will not stop a big increase in normal production proceeding side by side with it. A steady and insistent demand would enable modern large-scale methods to be applied with a consequent immense saving in labour and material. Thus modern methods make possible a rise in the standard of living in spite of rearmament, although, of course, the rise would be even greater if all production was for normal use, but savings in labour by modern methods make it even more imperative that the standard of living should rise, and that steps should be taken to ensure production is continued when the artificial stimulus of rearmament is removed.

## THE SUMMING UP

**PRODUCTION** is solved.

There is danger of an overwhelming flood of production.

We have poverty in the midst of abundance.

Suggested remedies :

Increased purchasing power essential. Mainly amongst working and poorer classes.

Higher wages, higher salaries and more leisure, will mean higher profits, more savings and a healthier and fuller life for all.

Money must be regulated to keep pace with production, and its value stabilised in terms of purchasing power—not its metallic content.

The supply of money and credit must be increased as long as prices do not rise to any appreciable extent, and as long as unemployment exists.

When everybody is employed the position should be reviewed. It may still be necessary to further increase the supply of money and credit if a higher standard of living is to be attained.

We must resume lending abroad, and whilst not forgetting or neglecting our own industries we must foster foreign trade as much as possible.

We must develop and conserve our own resources to the fullest possible extent and institute an active reconstruction programme.

We must plan production and consumption.

## APPENDIX

### BANK RATES, 1912-36

per cent.

1912	Feb.	8	3½	
	May	9	3	
	Aug.	29	4	
	Oct.	17	5	War, Turkey and Balkan States.
1913	April	17	4½	
	Oct.	2	5	
1914	Jan.	8	4½	
	"	22	4	
	"	29	3	
	July	30	4	
	"	31	8	} Outbreak of Great War.
	Aug.	1	10	
	"	6	6	
	"	8	5	
1916	July	13	6	
1917	Jan.	18	5½	
	April	5	5	
1918	Nov.	11		Armistice Day
1919	"	6	6	Deflation begins.
1920	April	15	7	
1921	"	28	6½	
	June	23	6	
	July	21	5½	
	Nov.	3	5	
1922	Feb.	16	4½	
	April	13	4	
	June	15	3½	
	July	13	3	
1923	"	5	4	
1925	March	5	5	Return to Gold Standard, April 29,
	Aug.	6	4½	1925.
	Oct.	1	4	

## APPENDIX

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## BANK RATES, 1912-36 (continued)

		per cent.		
1925	Dec.	3	5	First signs of gold going to France.
1927	April	21	4½	
1929	Feb.	7	5½	
	Sept.	26	6½	Stock Exchange Boom in America.
	Oct.	31	6	
	Nov.	21	5½	
	Dec.	12	5	
1930	Feb.	6	4½	
	March	6	4	
	"	20	3½	
	May	1	3	
1931	"	14	2½	
	July	23	3½	
	"	30	4½	
	Sept.	21	6	Suspension of Gold Standard. Price
1932	Feb.	18	5	of gold, September 19, 1931, was
	March	10	4	84s. 11d. per ounce; on September
	"	17	3½	26, 1931, it was 101s. 9d.;
	April	21	3	during 1935 it rose to nearly 150s.,
	May	12	2½	but fell to 141s. and has since been
	June	30	2	maintained about this price.

The last time Bank Rate was 2 per cent. was May 13, 1897.

The U.S.A. dollar exchange rate fluctuated between 3.22 and 3.42 to the pound during 1932. The U.S.A. banking crisis came to a head on March 11, 1933, from which date the dollar rate rose very rapidly for a short time and reached 5.50 on November 16, 1933. From that date it fell to about \$5, and has remained very much about that figure ever since.



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AND AFTER SUSPENSION OF THE GOLD STANDARD.

Extracted from "The Times" of December 30, 1935.

	Price Dec. 27, 1935.	End Year 1934.	Lowest Price 1931.
(a) Consols 2½% . . . . .	86	93	49½
(a) " 4% 1957 . . . . .	115½	117½	77½
(a) " 3½% 1961 . . . . .	107½	111	67
" 4½% 1940-44. . . . .	110½	113	88
" 5% 1944-64 . . . . .	110½	123½	93
Funding 4% 1960-90 . . . . .	116½	120½	78
(b) Victory 4% . . . . .	115½	118½	85
(a) War Loan 3½% . . . . .	105½	108½	90½*
(a) Local Loans 3% . . . . .	95½	97½	57

(a) Redeemable at Government option.

(b) Redeemable by drawings.

\* Was 5% War Loan. Prior to conversion to 3½% War Loan this stock was redeemable at 100 at option of the Government between 1929 and 1947 but had to be redeemed by 1947. In its present form it is only redeemable at Government option.

WHOLESALE PRICES

Extracted from "The Statist."

(Averages in 1913=100)

Year.	Year.
1913 . . . . . 100	1932 . . . . . 94
1920 . . . . . 295	1933 . . . . . 93·7
1921 . . . . . 182	1934 . . . . . 96·4
1922 . . . . . 154	1935 . . . . . 99·5
1923 . . . . . 152	1936 :
1924 . . . . . 164	Jan. . . . . 102
1925 . . . . . 160	Feb. . . . . 102
1926 . . . . . 148	March . . . . . 101·6
1927 . . . . . 144	April . . . . . 100·9
1928 . . . . . 141·2	May . . . . . 100·2
1929 . . . . . 135·3	June . . . . . 99·3
1930 . . . . . 114·1	July . . . . . 102·1
1931 . . . . . 96·5	

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