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**THE FIRST YEAR OF THE
GOLD STANDARD**

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OF THE
GOLD STANDARD

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FOREWORD

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T. E. GREGORY.

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THE FIRST YEAR OF THE GOLD STANDARD

I

THE THEORY OF STABILISATION

§ I

There are some acts of State which close historical controversies. The decision of the Baldwin Government to return immediately to the gold standard, a decision announced to the world on 28th April, 1925, was one of these. For though the step had been preceded by the stabilisation of the German, Austrian, Hungarian, Swedish and Russian currencies and by the announcement of independent action by the Union of South Africa, the step taken by the British Government represented the definitive shifting of the balance of power in the sphere of monetary policy. Up to that moment of time there was always the chance that out of the conflict between the golden dollar and the paper pound a permanent division of the world's monetary systems might develop; as it is, stability in rates of exchange and reasonable stability in the price-level has been preferred both to the possibilities of complete stabilisation and the practically much greater probability of a progressive fall in the

value of money. The re-adoption of the gold standard may prove in the future to have been the wrong policy to adopt: revolution may undo again what was done last year, or the slower and more subtle modifications which the development of technique can bring with it may perhaps make the recent change irrelevant. But for the moment the fundamental decision, fatal or beneficent, good or evil, has been taken: and we are now concerned, not with questions of high principle, but with questions—irritating, difficult, insistent questions—of immediate policy and results. It is with these questions, and not with the gold standard as such, that we are concerned here. What have been the problems, what the economic environment, of the last eighteen months?

Those who agree with the School of Mr. Keynes, that the gold standard is *intrinsically* undesirable, will find in the experiences of the last year and a half additional reasons for regret. And even of those who approve, on general grounds, of the gold standard, some may believe that it would have been better to wait for a more propitious moment, or, whilst thinking that the moment had come for a return to gold, would have preferred to have seen a new parity point fixed between the paper pound and the re-created gold pound. Others, again, deny that the immediate sacrifices incurred outweigh the immediate and future benefits to be derived from the return to gold on the basis actually chosen. And, lastly, it is affirmed by some and denied by others, whether supporters of the gold standard or not,

that the period of transition is over and that the difficulties of adjustment have been successfully surmounted. Opinion, in other words, has ceased to divide into two directly opposite and conflicting camps, each respectively affirming and denying certain plain and direct theses: we have arrived at that confusing and depressing period when doubt as to the wisdom of the course taken, the disappointment of exaggerated hopes, weariness of the whole controversy, the absence of clear-cut issues, the dying down of the fighting mood and the reaction from victory gained, all combine to produce mental staleness and emotional indifference.

§ 2

In the first stages of the reform campaign after the war attention was concentrated largely on the question of the return to the pre-war parity as against stabilisation on a basis near to, or at, the actual rate which the forces at work on the exchange market—primarily, of course, the currency policy which had actually been pursued—had established. By the time of the Genoa Conference it had become generally recognised that “for countries where currency has fallen very far below the pre-war parity, a return to it must involve the social and economic dislocation attendant upon continuing readjustments of money wages and prices, and a continual increase in the burden of internal debt.”¹ But this,

¹ *Papers Relating to International Economic Conference, Genoa, 1922*, p. 66.

though an important issue, was not the only, or perhaps even the most important, problem to be faced, as we can now see, so far as the majority of countries are concerned. For the countries with the most depreciated currencies such a step was not in any case possible; for countries with the less depreciated currencies the problem was at first exaggerated by the confusion between the return to a pre-war parity with gold and the return to pre-war prices. So long as it was assumed that the first step involved the second also, naturally the magnitude of the problem was likely to deter any efforts to return to the pre-war par. But, by the time it was recognised that so long as the United States dollar remained depreciated in terms of goods, the restoration of pre-war parity meant in fact an assimilation of local prices to American ones, the march of theory had also revealed the fact that the problem of stabilisation involved an issue much more subtle than the absolute degree of depreciation in the rates of exchange, and the division of countries with depreciated currencies into two groups, those slightly and those considerably depreciated. The line of division which began to be drawn was between countries with overvalued, and exchanges with undervalued, currencies, the basis of comparison being wholesale prices: the problem had been debated between Professor Cassel,¹ Dr. Van Dorp,² Professor Pigou³ and others

¹ *Ec. Journal*, XXVI., March and September; XXVIII., December; XXIX., December.

² *Ec. Journal*, XXIX., December & XXX., September.

³ *Ec. Journal*, XXX., December.

before the worst excesses of inflation had been committed. It was these which gave still another twist to discussion of exchange problems, because interest in the deviations in the actual exchange from the "purchasing power parity" in terms of wholesale prices, gave way to problems concerning the adoption of a stabilisation ratio: a choice could be made, it was soon discovered, between the *external* and the *internal* value of the currency. If the external value were lower than the internal value—if, that is, home prices converted into gold or dollars at the current rate of exchange were less than world gold prices—stabilisation at the external value, so far from implying deflation, implied further inflation; if domestic prices, converted into gold or dollars at current rates of exchange, were higher than world prices, the degree of price reduction involved was the difference between the world price-level and the local price-level plus any further deflation required to raise the actual rate of exchange itself by a given amount. Since the possibility of deviation between internal and external parity was present both in the case of countries with slightly and those with considerably depreciated currencies, in all cases the question arose, which is better, stabilisation at the higher or at the lower value of the currency? The *practical* alternatives are: (1) *the choice of the current rate of exchange*, which is equivalent to stabilisation at the higher value of the currency if the exchange overvalues the currency relatively to its domestic buying power and is equivalent

to stabilisation at the lower value of the currency if the exchange undervalues the currency relatively to its domestic buying power; (2) *the choice of an alternative rate*, which will be higher than the existing rate if the actual rate undervalues the currency, and which will be lower than the existing rate if the latter overvalues the currency.

§ 3

The first scientific attempt to work out a stabilisation scheme for a country suffering from post-war depreciation was that of the Berlin Experts Committee of November, 1922.¹ At that time in Berlin the dollar rate was 7,000 marks. Messrs. Brand, Cassel, Jenks and Keynes, the Majority Commissioners, opted for a stabilisation rate based on the higher internal purchasing power of the mark, on the ground that "the recent great collapse is mainly due to a failure of confidence, and if the measures indicated . . . are taken, a great improvement might occur immediately."² But when the Austrian, German and Hungarian currencies came to be definitely stabilised between 1922 and 1924 the stabilisation rate adopted was the current rate of exchange, which was in all these cases the lower value of the currency. When the Swedish currency was stabilised in 1924 and the British currency stabilised in 1925, the rate, already near par,

¹ *Gedachten der internationalen Finanzexperten über die Stabilisierung*. Berlin: Auswärtiges Amt, 1922.

² Report cited, p. 18.

was allowed to rise to par. But the important point was the fact that, whether at or near par, the actual rate represented the higher of the two values of the currency.

Which policy ought to be adopted? Since either policy may involve difficulties, it might be argued that stabilisation should never be attempted unless the internal and external values of the currency have coincided over a considerable period of time. But it is exceedingly questionable whether the two values will in fact correspond closely for long periods of time. The two values will not correspond without stabilisation: but stabilisation is held to be impossible without coincidence. It is true that forces are constantly at work tending to bring about coincidence: on this fundamental fact rests the whole theory of purchasing power parity. But since—apart from quasi-permanent influences which may be held to effect lasting deviations—the rate of exchange is an expression of the monetary policy not of one area but of two, even a stable price policy in the country which desires to stabilise its rate of exchange may still produce deviations in the rate owing to coincident changes in the other country, tending either to over- or undervaluation. Further, the stabilisation policy itself is a factor in the situation: a declaration that a country intends to stabilise will cause movements even if the stabilisation rate is not yet definitely announced, whilst the declaration that a country does *not* intend to stabilise would also cause movements in the rate. In practice,

moreover, the facts of the situation are never exactly known at the time: the calculation of deviations, on whatever basis it may be made, is always an *ex post facto* event. There may at different periods be a greater or smaller deviation, and at times no deviation at all, but in practice the choice between the higher and the lower value of the currency has usually to be made.

§ 4

But how measure the deviations between external and internal value: how determine whether the country has a higher purchasing power inside or outside the country? Earlier discussions concerned themselves primarily with deviations between actual rates of exchange and "calculated" rates, using wholesale prices to establish the degree of deviation. This practice first began to be improved upon when the serious fall of the German mark gave rise to the problem of "export bounties" based on the non-adjustment of German wages to the fall in the dollar value of the mark.¹ The significance of the non-uniformity in the movement of different prices to the doctrine of *purchasing power parity* was emphasised by Mr. Keynes in his *Monetary Reform*. And, lastly, it is Mr. Keynes who, particularly, has emphasised the importance of non-uniformity of price movements *to the doctrine*

¹ e.g. the concluding paragraphs of the chapter "Deviations from Purchasing Power Parity" in Cassel's *Money and Foreign Exchange after 1914*; 1922, p. 147 et seq., esp. pp. 159-169. See also the U.S.A. Tariff Commission Report of 1922 on *Depreciated Exchange and International Trade*, where cost of living figures first seem to have been employed, esp. p. 56 et seq.

of stabilisation, particularly as regards the *degree of adjustment* which is necessary or which has been attained at a given moment, and also as regards the expediency of *particular modes* of stabilisation.

The argument is that an index-number of wholesale prices throws no light upon the degree of adjustment which is necessary because "such an index-number is largely made up of unsheltered prices, which are necessarily, whatever happens, 'nearly the same'¹ in all countries: and *must* be the same in the case of true international commodities such as "cotton, copper and export grades of coal."²

This is true enough: though of course it does not follow that the process of adjustment does not involve loss or gain, e.g., in the case of stocks which have to be revalued when the exchange alters. Nor is it easy to find examples of prices, significant for the problem of stabilisation, which are independent of movements in prices which *are* affected by changes in wholesale prices. The cost of living certainly is not, considering that food enters into the British cost of living index to the extent of 60%; and that textile prices and the price of new houses are all affected by the cost of imports. So far as wages are governed by cost of living indices, they vary indirectly with the prices of wholesale articles: in so far as wages are not directly governed by cost of living figures, they at least are affected by the demand for labour, and, consequently, are influenced by

¹ *Ec. Journal*, XXXV., p. 301; *Times*, 4th September, 1896; more extravagantly stated, *Economic Consequences of Mr. Chamberlain*, p. 11.

² *Op. cit.* in note 1, p. 8.

the state of employment in industries directly under the influence of international competition. Since all prices are ultimately a function of monetary policy, the prices of goods and services of all groups must tend to rise and fall together. Hence the degree of divergence between the internal and external value cannot be indefinitely great: hence the extent to which particular indices of price are evidence of maladjustment is only one of degree: hence, also, the extent to which maladjustment exists is always a subject of dispute.

But the evidence which can be used to prove existence of maladjustment is a much less important matter than the manner in which adjustment can be brought about if there is maladjustment.

§ 5

There are, as we know, two possible solutions; each involves the possibility of trouble. When stabilisation is effected on the basis of the higher value of the currency, the trouble takes the form of an *adjustment crisis*. When, on the contrary, stabilisation is effected on the basis of the lower value of the currency, there may be no immediate difficulties, but a somewhat more distant crisis appears, which we may call a *stabilisation crisis*. Great Britain is passing through the troubles associated with an adjustment crisis, Germany through those connected with a stabilisation crisis. The specific phases are examined later: the general problems here.

When the higher value of the currency is adopted as the basis of stabilisation, the magnitude

of the problem to be faced varies with the extent of the divergence of the two values, and the elasticity of the "factors of production." In the trades directly associated with exports, prices in terms of world currency mean a smaller return in the local currency. Meanwhile all expenses in terms of the local currency remain what they were. How will adjustment be made? If wages in the exporting industries remain fixed, if there is no possibility that depression in these trades will lower supply prices in other industries, if, in spite of the fact that wages and prices in other industries are not directly affected, labour cannot be transferred and by competition reduce wage rates, and by increasing supply, reduce supply prices, if there is no reduction in the cost of living, or, if there is a reduction, it is not allowed to affect wage rates; if, in other words, we assume a rigid, water-tight organisation of labour, a quasi-monopolistic organisation of industry, there will be no speedy adjustment. Under such conditions real wages in the "sheltered" trades will rise, unemployment will increase, exports will fall off and imports will increase. If, at the same time, the working classes are told that the object which the standardisation is intended to attain "is an essential emblem and idol of those who sit in the top tier of the machine,"¹ that these Great Ones are "immensely rash in their regardlessness, in their vague optimism and comfortable belief that nothing really serious ever happens,"¹ that "wages should be fixed as to

¹ Keynes, *Economic Consequences of Mr. Churchill*, pp. 23-4.

what is 'fair' and 'reasonable' as between classes,"¹ but no indication is given as to how this standard of fairness and reasonableness is to be transmuted into actual wage rates and earnings, the psychological conditions will be created for reinforcing the natural dislike to a reduction of money wages by the appeal which "ignorance and prejudice" can make when they are lent the assistance of great names, and the transition will be made socially as well as economically more difficult.

What is the credit policy which should accompany stabilisation at the higher value of a currency?

What is wanted is a lower level of prices. If the Central Bank does nothing at all and simply allows gold to flow out, or, what comes to the same thing, allows its stock of foreign currency to fall off, that in itself causes a lower level of prices, because currency is cancelled in order to obtain gold or exchange for export purposes. Such reduction, direct or indirect, in the volume of currency leads to higher money rates and then to a higher official rate of discount. If the Central Bank replaces its cash reserves by additional securities, it prevents the efflux of gold or the reduction of reserves of foreign exchange from working out their own cure. Since a given absolute reduction in reserves means a more than proportionate reduction in reserve ratios, it follows that if the absolute size of the reserve is small, and the ratio also is small, that the Central Bank will try to *anticipate* the ultimate effect of

¹ *Op. cit.*, pp. 33-4.

² Mr. Keynes on the use made by the popular Press of Sir W. Beveridge's Presidential Address at the British Association, 1923. *Ec. Journal*, XXXIII, p. 486.

reductions in reserves, either by selling securities, which will cause money rates and ultimately its own official rate to rise, if the demand for credit continues, or by putting up Bank rate at once.

Whichever policy the Bank adopts it is sure to be criticised. If it simply allows its reserve to fall, it runs the risk—greater or less according to the circumstances of the case—of creating alarm in the Money Market, and, since money rates will certainly rise as the gold leaves, will incur ultimately all the unpopularity associated with dear money. If it insists on dear money at once, it probably achieves its end more quickly, but runs the risk that public opinion will defeat its policy on the ground that it is pursuing a "deservedly hateful" policy, viz. the temporary intensification of unemployment.

The conclusion would, therefore, seem to be that the more inelastic the organisation of labour, the more the divergence of the internal and external value, the greater the possible loss of reserves, the higher the likely rise in money rates, the more intense the temporary volume of unemployment, the greater the social unrest likely to be generated, the more attractive immediately the alternative policy of stabilising at the lower value of the currency. To the effects of this we now turn.

§ 6

When the lower value of the currency is its external value, internal prices must be allowed to rise until they reach a level at which they equilibrate with external prices at the stabilisation rate adopted. The greater the divergence between the

two values of the currency, the lower the gold value of wages and cost of living inside the country, the greater the internal rise of prices will have to be and, therefore, the greater the encouragement to the "productive" classes. For the time, at any rate, the path of virtue is strewn with roses: employment improves, real and nominal wages rise, the volume of trade expands, the chance of larger profits attracts foreign capital and the higher prices attract imports, which the foreign loans help to finance.¹

When the lower value of the currency, is its internal value, the stabilisation rate chosen will be lower than ruling rates of exchange. Anticipation will no doubt drive the rate down even before the definite stabilisation rate is decided upon: if speculation overdoes its bear raid, it may even force a still lower rate than the one originally decided upon. The fall in the exchange will for the time being check imports and stimulate exports, will thus cause a boom in the export trades, and may lead to a demand for greater credits from the banking system, an expansion of currency and an increase of employment. The greater the previous divergence, the greater therefore the fall in exchange rates, the greater the stimulus to employment and the greater the optimistic mood engendered.

But the real crisis is yet to come. The "hateful necessity" for damping down the rate of expansion must be faced. If the Central Bank

¹ As the case of Germany shows, immediately following stabilisation there may also be a true adjustment crisis lasting for some time.

attempts to interfere *before* final adjustment is reached, it will not indeed commit itself to the "deservedly hateful" policy of accentuating depression: it will only enrage the business classes by checking a temporary boom. Nevertheless, it *must* intervene at some stage. If it does not, then sooner or later internal and external prices will be out of touch again, gold flows out and reserves of foreign exchange fall, Bank rate or open-market policy will have to be utilised and deflation practised, *after* the levels are out of touch, instead of at the point when they threaten to get out of touch. The alternative is to abandon exchange stabilisation altogether and to "concentrate on stability of internal prices," leaving the exchange to look after itself.

This policy—which is Mr. Keynes'—assumes that on the side of the foreign exchanges, the adjustment of the exchanges to the internal and external price-levels is sufficiently swift and automatic as not to give rise too frequently and to a too significant extent to the phenomenon of over- or undervaluation. Since a fluctuating exchange involves the possibility of speculative exploitation, an element of uncertainty not connected with the movement of prices necessarily arises. The extent to which exchanges do respond *quickly* is a question of fact. But the difficulties of the policy recommended lie in the technique of internal stabilisation, and, whatever may be said of the possibilities of the future, it is at least clear that the choice of the level upon which to stabilise is a matter of great complexity.

If any level other than the price-level at the moment of initiating the process of stabilisation is chosen, there must necessarily be inflation or deflation, and even if the existing price-level is adopted, it must be prevented from rising (there is no need to worry about the steps necessary to prevent it falling). It is not by any means obvious that the process of stabilisation would not at times result in the volume of unemployment temporarily increasing.

Opinion, it is known, finds bear speculation more odious than bull speculation. Falling prices are, in other words, unpopular, whatever their ultimate social consequences may be. It is, therefore, other things equal, more expedient to stabilise on the basis of the lower value of the currency, because this does not involve falling prices, unemployment and, with these, the unpopularity of the end it is desired to achieve. And if the only question which has to be considered is the direct question of expediency, expediency should carry the day. Whether, in the case of this country, there is anything to be said for adopting the pre-war parity is a point upon which something must be said below. What should be clear from the above is that so long as there is, at the moment of stabilisation, a divergence between internal and external values, stabilisation involves the choice between an immediate and a more remote shock, the magnitude of which will vary with the degree of divergence, the elasticity of industrial organisation and the skill and vision of the monetary authorities.

II

SOME RECENT CASES OF STABILISATION

§ I

It makes very little difference from the economic point of view, though a good deal from the practical, whether formal stabilisation takes place after or before the adjustment of internal and external prices has been made. Permanent stabilisation is impossible without adjustment: but if the adjustment takes place in order that stabilisation may come about, and the formal inauguration of a fixed parity is then delayed, any difficulties which may arise are not directly attributed by public opinion to the return to a fixed parity of exchange. If adjustment takes place *after* the formal return to a fixed parity, the odium which may attach to the methods employed is carried over to the end to be attained. And thus the return to gold may be acclaimed as an act of statesmanship in one country and may be denounced as an act of folly in another, simply because in the one case the return to gold has preceded, in the other case has been preceded by, the difficulties due to the methods adopted. So in Holland and in Sweden the worst was over before gold parity was restored: in Germany a sufficient interval of time elapsed between stabilisation and crisis to subdue any inclination

(had there not in any case been the previous experiences of inflation to deaden opposition) to tamper with the new basis of the currency. In this country the unpopularity of the gold standard, in so far as it is unpopular, is due to the fact that stabilisation preceded adjustment. In the Latin countries public opinion is still in that state of indecision when it dislikes the present and fears the future. In Denmark and in Norway the actual basis of stabilisation is being modified by the experiences through which these countries have been passing.

§ 2

The world situation in which the British experiment has been proceeding is not an easy one to describe. For though the course of production, the state of employment and the level of interest rates are all affected by the temporary circumstances of inflation, deflation or stabilisation in particular areas, they are also affected by the gradual restoration of productive capacity after the war, the growing pacification of public opinion due to the gradual settlement of the outstanding political problems of the period, by the growth of population, the relative bargaining power of the agricultural classes and the like. On the whole these latter factors make for increased production: inflation stimulates production at the same time that it makes for future impoverishment: deflation and stabilisation crises alike make for diminished productivity at the

moment. The German Imperial Statistical Office and the Institut für Konjunkturforschung, issuing their first survey on the "World economic position at the end of 1925,"¹ describe the year 1925 as one of stagnation. They summarise the position as follows: "The year 1924 restored the economic solidarity of the Central and West European countries and, for the first time since the outbreak of the war, brought about in the second half of the year definite connections in the course of the world trade cycle. In the year 1925 the uniformity of the international trade cycle continued and was consciously apprehended, especially in the co-operation of leading central banks. . . . But whereas in the previous year the growing international solidarity was manifested in the expansionist tendency in the various countries associated internationally, this improvement at the turn of the year almost everywhere came to an end, and was displaced by a stagnation which became more marked month by month. This change in the world situation was marked by a general fall in the world level of prices, a decline in trade turnover and in the demand for credit, a growing unemployment in Western and Eastern Europe and in a portion of the Overseas Areas. The decline in European coal production and a universal regression in the world trade in Coal, finally the difficult position of the world trade in Iron and Steel and in portions of the Textile Industry, express the same tendency."

¹ Die weltwirtschaftliche Lage Ende 1925. Herausgegeben vom Statistischen Reichsamt und vom Institut für Konjunkturforschung. Als Manuskript gedruckt. Berlin, 1926.

§ 3

The question is, however, "whether the uniformity of the development is perhaps merely the casual result of the interaction of quite independent factors?"¹ The German report believes that such proximate general factors were the exchange-dumping of the heavy industries in countries with depreciated currencies, the bad European harvests which did not, owing to falling yield, increase the real purchasing power of the peasant class very appreciably,² and the decline in American capital exports which checked the "artificial" boom in European industry.³

The *ultimate* cause of the stagnation the Report finds in the continuing, even intensified, disequilibrium between European productive capacity and the power and willingness of the world market to absorb European products, that is, in a decline in Europe's share of world trade. A later report of the same authority brings figures to show that, in comparison with 1913, the trade of the main European countries (basis Board of Trade index number) was:

1924 ⁴		1925 ⁴	
Imports ..	80.1	Imports ..	86.5
Exports ..	76.0	Exports ..	80.5
Total ..	78.2	Total ..	83.8

¹ Op. cit., p. 9.

² Thus in Germany a 80% to 40% increase in the purchasing power of agricultural products only increased the purchasing power of agriculture by 10% to 15%. Op. cit., p. 13.

³ Op. cit., p. 12.

⁴ The countries included in this computation are: Belgium, France, Great Britain, Italy, Holland, Sweden, Switzerland. *Verteljahreshefte zur Konjunkturforschung*. 1926, Heft I., p. 67.

§ 4

To go further into this side of the problem would be to turn away from the main purpose. The German analysis is, at any rate, a useful reminder of the fact that, in addition to the monetary factors at work, there are others less on the surface and more slow-moving in their effects. One feature of the last year and a half, however, is so interesting in itself, and so indicative of the re-emergence of world equilibrium, that it deserves a passing word. This is the growing tendency towards a more uniform level of interest rates in the world's money markets.¹

If the world's price-level, in terms of gold, were absolutely stable over time, the relative height of interest rates would mark only the relative urgency for short period supplies of funds. Countries with the larger margin of current production over current consumption would have low rates of interest: those with small margins would have higher rates of interest: rates at least so much higher as to attract funds from other countries. Under such conditions the real rate of return would not be everywhere the same, but increasing productivity all over the world would drive the whole system of rates downwards. The margin between the rates would widen or contract, partly with the relative volume of current savings in each part of the area and partly with the rapidity with which loans were placed at the disposal of the areas with the

¹ *of Commerce Monthly*, June, 1926; *Trend of European Money Rates*; *Quarterly Report, Statistisches Kreditinstitut*, July, 1926; *Interest Rates and the Share Market*.

§ 6

Nevertheless, the restoration of stable currencies means that over the greater part of Europe and the world the wholesale price-index cannot be widely different in different countries so long as the indices are constructed on the same basis. This being so, the gradual approximation of interest rates, apart from countries where inflation is still an acute factor of the situation, are indicative of the underlying economic situation to some considerable extent, though the factor of monetary policy is still a disturbing factor to be taken into account.

The tables which follow show that the money markets can be divided into four groups :

(1) A group, including Zurich, Amsterdam and New York, with *low* money rates, the tendency of the rates being to fall still lower.

(2) A group of inflationist areas where money rates are obviously out of touch with the movements of the price-level.

(3) A group—Germany, Austria, Czechoslovakia and others—with high rates falling sharply.

(4) A fourth money market, namely the British, in which, in contradistinction to the others, rates have been rising, and which is intermediate between the first group and the third.

This position of interest rates is what, on the

whole, one would expect. Even if one knew nothing of the monetary policy being pursued by particular authorities, one would be inclined to say that the European neutrals and the U.S.A. would tend to have the lowest rates, that rates in Great Britain would be higher but not so high as in Central Europe, whilst the final equilibrium rate in France would be nearer to the British, and that of Italy nearer to the German-Austrian, the position of the Belgian rate again being intermediate between the French and German.

It is not yet clear that the present tendency to uniformity will maintain itself, at any rate quite on the present lines. Once British prices have adjusted themselves to the world level, the tendency will be for British rates to fall: whilst industrial recovery in Germany is likely to make German rates rise. Stabilisation in the Latin countries is likely to affect Swiss and Dutch rates in an upward direction, since balances will tend to be withdrawn from these centres.

	London Rate of Discount	Market Discount Rate in New York ¹	F. R. Rate for Bills purchased in open Market ¹	Bank of England Official Rate	New York Official Discount Rate	London over or under New York (+) or (-)
1924						
January ..	3.29	4.125	4.10	4	4½	-0.8
February ..	3.64	4	4.09	4	4½	-0.4
March ..	3.20	4.125	4.09	4	4½	-0.9
April ..	3.10	4	4.07	4	4½	-0.9
May ..	3.00	3.375	3.29	4	4½	-0.4
June ..	2.96	2.25-2.375	3.13	4	4-3½	+0.7
July ..	3.56	2 ²⁵	2.30	4	3½	+1.6
August ..	3.82	2	2.25	4	3½-3	+1.8
September ..	3.79	2.25	2.21	4	3	+1.5
October ..	3.70	2.25	2.14	4	3	+1.5
November ..	3.72	2.25	2.30	4	3	+1.5
December ..	3.68	2.875	2.77	4	3	+1.8
1925						
January ..	3.82	3	3	4	3	+0.8
February ..	3.77	3-3.125	3.10	4	3-3½	+0.8
March ..	4.50	3.25	3.15	5	3½	+1.3
April ..	4.29	3.25	3.10	5	3½	+1.0
May ..	4.69	3.125	3.10	5	3½	+1.5
June ..	4.41	3.125	3.13	5	3½	+1.3
July ..	4.43	3.125	3.08	5	3½	+1.3
August ..	4.02	3.125	3.09	4½	3½	+0.9
September ..	3.79	3.50	3.31	4½	3½	+0.3
October ..	3.42	3.50	3.30	4	3½	+0.1
November ..	3.90	3.50	3.31	4	3½	+0.3
December ..	4.71	3.50	3.31	5	3½	+1.2

¹ Federal Reserve Board Report, 1924, p. 27; Federal Reserve Board Report, 1926, p. 41.

² Federal Reserve Board Report, 1925, p. 202.

AMSTERDAM

Last day of	Private Discount		Official Rate
	% ¹		% ²
1923			
January ..	3½-3½	(last week of month)	4
February ..	3½-3½	"	4
March ..	2½-3½	"	4
April ..	3½	"	4
May ..	3½-3½	"	4
June ..	3½	"	4
July ..	3½-3½	"	4
August ..	2½-2½ ³	"	4
September ..	3½-3½	"	4
October ..	2½	"	4
November ..	3½-4	"	4
December ..	4½-4½	"	4½
1924			
January ..	4½	(last day of month)	5
February ..	4½	"	5
March ..	5	"	5
April ..	5	"	5
May ..	3½	"	5
June ..	3½	"	5
July ..	2½	"	5
August ..	2½	"	5
September ..	4½	"	5
October ..	4	"	5
November ..	4½	"	5
December ..	3½	"	4½
1925			
January ..	2½	"	4
February ..	1½	"	4
March ..	2½	"	4
April ..	3½	"	4
May ..	3½	"	4
June ..	2½	"	4
July ..	3½	"	4
August ..	4	"	4
September ..	3½	"	4
October ..	3½	"	3½
November ..	3½	"	3½
December ..	3½	"	3½
1926			
January ..	3½	2½	3½
February ..	2½	2	3½
March ..	3	2½	3½
April ..	3½	2½	3½
May ..	3	2½	3½
June ..	3	2½	3½

¹ 1923 figures from supplement to *Weltwirtschaftliches Archiv*, October 1924, p. 3.
² 1924 figures from supplement to *Weltwirtschaftliches Archiv*, April, 1925 p. 2. 1925

figures from supplement to *Weltwirtschaftliches Archiv*, April, 1926, p. 2.

³ From Federal Reserve Bulletin.

⁴ August 18-18th.

⁵ Highest and lowest figures during month. (From the Monthly Review of the Rotterdamse Bankvereniging.)

Last day of	Day to day		Private Discount		Official Rate
	% ¹		% ²	% ³	% ⁴
1923					
January ..		8-10%			12
February ..		9-11½%			12
March ..		9-11%			12
April ..		12-15%			18
May ..		14-18%			18
June ..		13-16%			18
July ..		13-17% ⁴			18
		<i>Rate per day</i>			
August ..		1-1½%			30
September ..		1½-2%			90
October ..		2-5%			108
November ..		5%			108
December ..		½-1%			10 ⁵
1924					
January ..	87.6	½ <i>per mille</i>			10
February ..	34.9	1 ..			10
March ..	33.1	½ ..			10
April ..	45.5	1½-1½ ..			10
May ..	27.8	1-1 ..			10
June ..	22.6	1-1 ..			10
July ..	16.8	1-1 ..			10
August ..	17.1	1 ..			10
September ..	14.9	1-1 ..			10
October ..	14.1	1 ..			10
November ..	13.0	1 ..			10
December ..	11.1	11-13% ⁵	9.2		10
1925					
January ..	10.0	9-12%	8.3		10
February ..	10.6	9-11%	8.0		9
March ..	9.0	9-11%	8.0	8	9
April ..	8.5	8-11½%	8.0	8	9
May ..	8.8	8½-10%	8.0	7½-8	9
June ..	8.8	10-11½%	7.8	7½-7½	9
July ..	9.3	9-11%	7.9	7½	9
August ..	9.0	8½-10%	7.7	7½-7½	9
September ..	8.9	10½-12%	7.2	7-7½	9
October ..	9.4	9-11%	7.1	7-7½	9
November ..	8.5	9-11%	6.8	6½	9
December ..	8.8	9-11%	6.8	6½	9
1926					
January ..	7.1		6.3		8
February ..	6.0		5.5		8
March ..	5.7		5.0		7
April ..	4.6		4.9		7
May ..					17

¹ 1923 figures from supplement to *Währungsstatistisches Archiv*, October, 1924, p. 1.

² 1924 figures from supplement to *Währungsstatistisches Archiv*, April, 1924, p. 2. 1925

figures from supplement to *Währungsstatistisches Archiv*, April, 1925, p. 2.

³ From *Vierteljahrshöhe der Kontokorrentverrechnung* (1926), Heft I., p. 66.

⁴ From Federal Reserve Bulletin.

⁵ Middle of month.

⁶ Average rate for the year.

⁷ New rate on Rentenmark and stable currency loans.

BRUSSELS

Last day of	Private Discount	Official Rate
1923	$\frac{5}{8}\%$ ¹	$\frac{5}{8}\%$ ²
January ..	$5\frac{1}{2}$	$5\frac{1}{2}$
February ..	$5\frac{1}{2}$	$5\frac{1}{2}$
March ..	$5\frac{1}{2}$	$5\frac{1}{2}$
April ..	$5\frac{1}{2}$	$5\frac{1}{2}$
May ..	$5\frac{1}{2}$	$5\frac{1}{2}$
June ..	5	$5\frac{1}{2}$
July ..	5	$5\frac{1}{2}$
August ..	5	$5\frac{1}{2}$
September..	5	$5\frac{1}{2}$
October ..	$5\frac{1}{2}$	$5\frac{1}{2}$
November ..	$5\frac{1}{2}$	$5\frac{1}{2}$
December ..	$5\frac{1}{2}$	$5\frac{1}{2}$
1924		
January ..	$5\frac{1}{2}$	$5\frac{1}{2}$
February ..	$5\frac{1}{2}$	$5\frac{1}{2}$
March ..	$5\frac{1}{2}$	$5\frac{1}{2}$
April ..	$5\frac{1}{2}$	$5\frac{1}{2}$
May ..	$5\frac{1}{2}$	$5\frac{1}{2}$
June ..		$5\frac{1}{2}$
July ..	$5\frac{1}{2}$	$5\frac{1}{2}$
August ..	$5\frac{1}{2}$	$5\frac{1}{2}$
September..	$5\frac{1}{2}$	$5\frac{1}{2}$
October ..	$5\frac{1}{2}$	$5\frac{1}{2}$
November ..	$5\frac{1}{2}$	$5\frac{1}{2}$
December ..	$5\frac{1}{2}$	$5\frac{1}{2}$
1925		
January ..	$5\frac{1}{2}$	$5\frac{1}{2}$
February ..	$5\frac{1}{2}$	$5\frac{1}{2}$
March ..	$5\frac{1}{2}$	$5\frac{1}{2}$
April ..	$5\frac{1}{2}$	$5\frac{1}{2}$
May ..	$5\frac{1}{2}$	$5\frac{1}{2}$
June ..	$5\frac{1}{2}$	$5\frac{1}{2}$
July ..	$5\frac{1}{2}$	$5\frac{1}{2}$
August ..	$5\frac{1}{2}$	$5\frac{1}{2}$
September..	$5\frac{1}{2}$	$5\frac{1}{2}$
October ..	$5\frac{1}{2}$	$5\frac{1}{2}$
November..	6 $\frac{1}{2}$	7
December ..		7
1926		
January ..		7
February ..		7
March ..		7 $\frac{1}{2}$
April ..		7
May ..		7

¹ 1923 figures from supplement to *Weltwirtschaftliches Archiv*, October, 1924, p. 1. 1924 and 1925 figures given by the London Branch of the Belgian Bank for Foreign Commerce.

² From the Federal Reserve Bulletin.

MILAN

Last day of	Private Discount	Official Rate
1923	% ¹	% ²
January ..	5½	5½
February ..	5½	5½
March ..	5½	5½
April ..	5½	5½
May ..	5½	5½
June ..	5½	5½
July ..	5½	5½
August ..	5½	5½
September ..	5½	5½
October ..	5½	5½
November ..	5½	5½
December ..	5½	5½
1924		
January ..	5½	5½
February ..	5½	5½
March ..	5½	5½
April ..	5½	5½
May ..	5½	5½
June ..	5½	5½
July ..	5½	5½
August ..	5½	5½
September ..	5½	5½
October ..	5½	5½
November ..	5½	5½
December ..	5½	5½
1925		
January ..	5½	5½
February ..	5½	5½
March ..	6	6
April ..	6	6
May ..	6	6
June ..	7	7
July ..	7	7
August ..	8	7
September ..	8	7
October ..	8½	7
November ..	8½	7
December ..	8½	7
1926		
January ..		7
February ..		7
March ..		7
April ..		7
May ..		7

¹ 1923 figures from supplement to *Wirtschaftliches Archiv*, October, 1924, p. 3.
² 1924 figures from supplement to *Wirtschaftliches Archiv*, April, 1925, p. 2. 1925

figures from supplement to *Wirtschaftliches Archiv*, April, 1926, p. 2.

³ From Federal Reserve Bulletin.

PARIS

Last day of	Private Discount	Official Rate
1923	7/8 ¹	7/8 ²
January ..	4½	5
February ..	4½	5
March ...	4½	5
April ..	4½	5
May ..	4½	5
June ..	4½	5
July ..	4½	5
August ..	4½	5
September..	4½	5
October ..	4½	5
November ..	4½	5
December ..	4½	5
1924		
January ..	5	6
February ..	5	6
March ..	6	6
April ..	5½	6
May ..	5½	6
June ..	5½	6
July ..	5½	6
August ..	5½	6
September..	5½	6
October ..	5½	6
November ..	5½	6
December ..	6½	7
1925		
January ..	6½	7
February ..	6½	7
March ..	6½	7
April ..	6½	7
May ..	6½	7
June ..	6	7
July ..	5½	6
August ..	5½	6
September..	5½	6
October ..	4½	6
November ..	4½	6
December ..	4½	6
1926		
January ..		6
February ..		6
March ..		6
April ..		6
May ..		6

¹ 1923 figures from supplement to *Waltwirtschaftliches Archiv*, October, 1924, p. 2.

1924 figures from supplement to *Waltwirtschaftliches Archiv*, April, 1925, p. 2.

1925 figures from supplement to *Waltwirtschaftliches Archiv*, April, 1926, p. 2.

² From Federal Reserve Bulletin.

SWITZERLAND

Last day of	Day to day (Zurich)	Private Discount	Official Rate
1923	% ¹	% ¹	% ¹
January ..	1	2.20 (average for m'th)	3
February ..	1	1.86	3
March ..	1	1.36	3
April ..	1	1.25	3
May ..	1	1.45	3
June ..	1 - 1½	2.15	3
July ..	2 - 2½	2.87	4
August ..	2½ - 4½	3.62	4
September ..	2½ - 4	3.71	4
October ..	2½ - 3½	3.72	4
November ..	2 - 2½	3.67	4
December ..	4	3.59	4
1924			
January ..	1 - 2½	3½ (last day of month)	4
February ..	2 - 3	3½	4
March ..	3 - 3½	3½	4
April ..	2½ - 3½	3½	4
May ..	2 - 2½	3½	4
June ..	3 - 3½	3½	4
July ..	4	3½	4
August ..	3½ - 4	3½	4
September ..	3	3½	4
October ..	3	3½	4
November ..	2½	3½	4
December ..	2 - 3	3	4
1925			
January ..	2½ - 2½	2½	4
February ..	2 - 2½	2½	4
March ..	2½	2½	4
April ..	2½	2½	4
May ..	2½	2½	4
June ..	2	2½	4
July ..	2	2½	4
August ..	2	2	4
September ..	3	2	4
October ..	2½	2	3½
November ..	2	2½	3½
December ..	2½	2½	3½
1926			
January ..			3½
February ..			3½
March ..			3½
April ..			3½
May ..			3½
June ..			3½

¹ 1923 figures from supplement to *Währungsverhältnisse* Archiv, October, 1924, p. 2.
 1924 figures from supplement to *Währungsverhältnisse* Archiv, April, 1925, p. 2.
 1925 figures from supplement to *Währungsverhältnisse* Archiv, April, 1926, p. 2.
 * From Federal Reserve Bulletin.

VIENNA

Last day of	Private Discount	Official Rate
1923	% ¹	% ²
January ..		9
February ..		9
March ..		9
April ..		9
May ..		9
June ..		9
July ..		9
August ..		9
September ..		9
October ..		9
November ..		9
December ..		9
1924		
January ..		9
February ..		9
March ..		9
April ..		9
May ..		9
June ..		12
July ..		12
August ..		15
September ..		15
October ..		15
November ..		13
December ..		13
1925		
January ..	11 - 11½	13
February ..	11	13
March ..	10½ - 11½	13
April ..	10½	11
May ..	10	11
June ..	10	11
July ..	9½ - 9¾	10
August ..	8½ - 8¾	10
September ..	8½	9
October ..	8½ - 8¾	9
November ..	8½ - 8¾	9
December ..	8½ - 9	9
1926		
January ..	7½ - 8½	9
February ..	7½ - 7¾	8
March ..	7½ - 7¾	8
April ..	6½ - 7½	7½
May ..	6½ - 6¾	7½

¹ 1926 figures from III regelmäßige Jahressitzung der Generalversammlung der Oesterreichischen Nationalbank am 16 März, 1926. 1926 figures from Mitteilungen des Direktoriums der Oesterreichischen Nationalbank, 30th June, 1926, p. 189.

² From Federal Reserve Bulletin.

(I) THE CASE OF GREAT BRITAIN

(a) The Controversy

§ 7

Sterling-dollar exchange first began to rise sharply in the summer of 1924. By the end of 1924 it stood (monthly average) at \$4.694 to the £ sterling. Bank rate in London remained unchanged throughout the whole year at 4% ; the New York Federal Reserve rate, which had been 4½% since the beginning of the year, fell to 4% and then to 3½% in June, fell to 3% in August and then was unaltered to December. London discount rates, which had remained below New York rates until May, were as much as 1.8% above these in August, in the three months September to November were 1½% above New York rates, and in December were 1.8% above New York. Here is one explanation for the rise in sterling rates. During 1924 the British cost of living rose from 178 (1st quarter) to 181 (4th quarter) : the American gold cost of living rose in the same period from 170 to 173.

§ 8

The fact that the Gold and Silver Export Prohibition Act was due to lapse (so far as the regulation of bullion exports is concerned) was certain to raise the question of the future policy of Great Britain in the course of 1925. In

February, 1925, New York official rates rose to $3\frac{1}{2}\%$: the British rate rose to 5% . In March the spread in market rates widened (London over New York) to 1.3% . New York, though nothing was said officially in London, was freely discussing the possibility of a return to gold in this country, and was buying sterling in anticipation of the formal adoption of the gold standard.

The actual rise in the Bank rate was approved even by those who did not believe in the desirability of a return to the gold standard, then or in the future. Writing in the *Nation* on 21st February, 1925, Mr. Keynes said that he did not "believe that a somewhat higher Bank rate would do any harm, in view of the present tendencies of the price-level, to the volume of trade and employment, and that, in any case, the maintenance of our own equilibrium will soon require the support of a higher rate." So that the policy which commended itself to those who desired a return to the gold standard was also, for the time being, commending itself to those who desired a managed currency. Up to the end of March the *Nation* stalwarts contented themselves with resisting the arguments that a reduction of Bank rate should be employed as a means of reducing unemployment¹ and that

¹ *Nation*, 7th March, 1925, p. 790 : "It is not wise at the phase of the credit cycle which we have now reached, even if it is tempting, to try to cure unemployment by actual inflation. I doubt if a 5% Bank rate, which is not oppressive in itself, will do any measurable harm to employment, provided that the price-level shows no tendency to fall.

But producers must be guaranteed against a re-introduction of the discredited policy of Deflation.

On this particular issue Sir Josiah Stamp differed from Mr. Keynes. "There is nothing in the present position of British industry which would in itself call for an increase in the rate."—*The Times*, 3rd March, 1925.

formal stabilisation should be adopted *because* the exchange had risen to par.¹

§ 9

At the beginning of April, a month before the introduction of the Budget, a *Nation* leader argued that "a return to gold this year cannot be achieved without terrible risk of renewed trade depression and a serious aggravation of unemployment."² In the same number of the *Nation* Mr. Keynes argued that the evidence was in favour of the supposition that the British price-level was not adjusted to the exchange, using wholesale prices to establish this contention.

Thus, before the decision had been taken, the general line of argument against the return to gold was already fully developed. But they are not arguments against the gold standard; and they would have failed completely against even an immediate return to the gold standard, had that return involved a stabilisation rate not overvaluing the pound, and they would also lose in weight if investigation proved the over-valuation to be less than was feared.

§ 10

The official case for an *immediate* return to gold, on the basis of the pre-war parity, was

¹ "Is it not clear that the removal of the embargo should be the last stage of the transition—not to be accomplished until after sterling has been maintained at par *de facto* for some considerable time."—*Nation*, 21st March, 1926.

² 4th April, 1926, p. 7.

only published when the intention so to revert to gold had been publicly announced. The *Committee on the Currency and Bank of England Note Issues* argued that :

(1) Devaluation, "never . . . a policy which the United Kingdom could have adopted," need not be seriously considered, in view of the actual state of the exchanges.

(2) There was something to be said for adopting an attitude of reserve so long as there was hope that a rise in American prices would drive up exchange to par without the necessity for deflation. But the exchange had been driven up without the price-levels being adjusted.

(3) There was a difference of only $1\frac{1}{2}\%$ in the amount of deflation required to raise the exchange fully to par and that required to keep the exchange where it was. In any case, "to allow the exchange to fall back now with the certainty of having later on to raise it again would be a short-sighted policy, injurious to trade and industry."

(4) Stabilisation at the pre-war parity involved a "fall in the final price-level of a significant, though not very large amount, unless it should happen that a corresponding rise takes place in America."

(5) "The assimilation of the British currency to the gold currencies of the world is so necessary for the ultimate prosperity of British trade that any temporary disadvantage, if such arise, from the measures necessary to maintain parity will be many times outweighed."

§ II

The official case has been severely criticised by Mr. Keynes. The Report was "indolent and jejune"; it evaded the real questions, viz.: (a) "How much is sterling overvalued? (b) by what train of events will adjustment be brought about? . . . there is not a word in the Report to suggest that the Committee do view credit restriction with serious apprehension."¹ The Government experts thought in terms of wholesale prices "which are irrelevant or inappropriate to the matter in hand"; they "misunderstood and underrated the technical difficulty of bringing about a general reduction of internal money values."²

Of these charges some are justified; and others are overstated. It is true that the Committee thought in terms of wholesale prices, but so did Mr. Keynes himself to some extent, until *after* the Report of the Committee had appeared; it is probable that the case with which "general prices" could be reduced was exaggerated by the Committee, and they certainly did not commit themselves to a definite statement of the extent of sterling overvaluation, confining themselves to the statement that it was "significant." The Committee may have underrated the degree of credit-restriction necessary, but

¹ *Econ. Journal*, XXXV., p. 304.

² *Nation*, 16th May, 1926.

³ *Economic Consequences of Mr. Churchill*, pp. 10, 11. Cf. on this point Sir Josiah Stamp in *The Times*, 27th March, 1926.

⁴ The "cost of living" argument first appears in his attack in the *Nation*, 9th May, 1926.

the charge that they do not view credit-restriction as such with apprehension is beside the point; they thought the end to be attained worth the amount of restriction likely, from their point of view, to be required.

§ 12

The official case would have gained if the argument against devaluation had been more fully developed. The argument against such a step is simply the blow involved to British financial prestige, and, in the particular case of this country, this is obviously a matter of great importance. It is, of course, not merely a matter of the "pound looking the dollar in the face," an unreflecting piece of sentimentalism, but a question of how far the invisible income drawn from banking services would be reduced by the definitive repudiation of the old content of the gold pound. Given that the return to gold at the old par was likely to increase the real income of the country by the improvement of our international financial standing, and that a devaluation could not increase it as much, then, against the temporary losses due to overvaluation, there was a definite and permanent offset. If this permanent gain were small and the immediate losses great, the case for devaluation was strengthened. The great advantage of devaluation would have been that it would have cut the ground from under the feet both of those who, being opposed to the gold standard in any shape

or form, naturally used the immediate inconveniences of the transition as a means of creating prejudice against the gold standard itself,¹ and of those also who, while not opposed to the gold standard in itself, thought that the condition of British industry did not justify any pressure on industrialists. At the same time devaluation would have involved a fall in the exchange and thus caused a stimulus to exports. The gold standard would have started its new lease of life without immediately causing an increase of unemployment and without any immediate necessity for lowering money wages. Working class sentiment would thus not have been directly assailed.

§ 13

But, whilst it is not desirable either to increase unemployment, reduce money wages and offend working class sentiment without good reason, it is useless to allow working class sentiment to govern monetary policy. It would surely be going a little far to suggest that the particular scale of wages, absolute and relative, operative in the early part of 1925, possessed any particular sanctity, and that it is a sign of peculiar lack of social grace to suggest a monetary standard which may involve a reduction of money wages. And, therefore, whilst it may be politically inexpedient to have to confess that the reform of the currency may involve price-reductions

¹ "The monetary policy, announced in the Budget, being the real source of our industrial troubles, it is impossible to recommend any truly satisfactory course except its reversal."—Keynes, *Economic Consequences*, p. 24.

(including money wages), and it is, therefore, better to devalue than to deflate, other things equal, it is as well to recognise that both the return to gold in any form and the adoption of a stabilised currency in terms of goods in general are likely, sooner or later, to clash with trade union philosophy on the subject of wages. The implicit assumption of those who believe that a "free" currency standard will prevent the emergence of awkward wage problems is that whenever money wages rise, the exchange will supply its own corrective to the extent required by the rise, neither more nor less. Wages and prices rise, the fall in the exchange just offsets the additional sterling cost to the foreign buyer, and, therefore, the relative competitive efficiency of the country is maintained. Is there not an element of "vague optimism" about this theory also? If the exchange falls by more than the required amount, the cost of living (in terms of imported goods) will rise and this time wages must not go up; real wages must, therefore, fall. But an undervalued exchange stimulates exports and creates a demand for labour; consequently, the basis for higher wages is created; wages rise. This rise justifies the actual position of the exchanges but, since at the new level of sterling wages exports become dearer, demand falls off; the cost of living remains up but money wages must fall, if more is to be exported. But wages cannot fall if the cost of living keeps up, and the cost of living keeps up because wages have not fallen.

* If, on the contrary, the exchange does not fall by the required amount, exports fall off and trade becomes depressed. Efforts are then made to reduce wages; the sheltered trades gain at the expense of the unsheltered. Wages do fall, and then trade improves again. And so, in the long run, the exchanges, cost of living, the level of sterling wages, visible and invisible imports and exports, all adjust themselves. But it would be wildly optimistic to suggest that the process is absolutely frictionless.

The case for devaluation should have been more carefully examined. But nothing is to be gained by pretending that it was the return to the gold standard which created the real wage-problem in this country, or that the definitive adoption of a managed currency would enable us successfully to overcome it.

§ 14

It would not have been worth while to devalue, still less to insist upon the inconveniences associated with the adoption of the old par, if there had been any sound reason for supposing that world prices would soon rise. Had there been strong reasons for this belief, Sir Josiah Stamp's "British industrialist" might well ask whether getting the gold standard a few months earlier than the natural time is really such a boon after all? "

By "natural time," one supposes, is meant the time when American prices were rising

¹ *The Times*, 3rd March, 1931.

sufficiently to cause the exchange to get to par. The policy involved two unknowns—the probability of American prices rising and the probability of our prices remaining constant. The expediency of *then* adopting the gold standard had, as a matter of fact, been already rejected by the *Nation* group: “to link sterling prices to dollar prices,” wrote Mr. Keynes,¹ “at a moment in the credit cycle when the latter were near their peak as the result of a boom which we had not fully shared, would ask for trouble.” But where was the evidence that prices in the States would rise enough by 31st December, 1925, by which time we had to have a decision one way or the other? The necessity for arriving at some decision was clear; had the Chancellor announced the return to gold at the end of the year, it would have made no practical difference; had he announced simply a prolongation of the Act he would have had to give some idea of policy—even if he had only announced that the “natural time had not yet come” he could not have prevented bear speculation and a new disequilibrium of the exchanges. The approximately “natural time” to return, then, was fixed by circumstances; but there is, in fact, no “natural” time to return and no “natural” rate at which to return, though there are methods of returning to gold more or less suitable to the circumstances. The return to gold had been proclaimed by every British Government in turn, and either deflation or devaluation would have

¹ *Nation*, 7th March, 1925, p. 790.

involved certain difficulties. The immediate difficulties of devaluation would have been less, but even this solution would still have involved the choice of a definite stabilisation rate.

(b) *The Facts before and since Stabilisation*

§ 15

Discussion of the direct consequences of the return to the gold standard has been much affected by the fact that Mr. Keynes employed, in comparing relative cost of living figures in this country and in the United States, the cost of living figures for the State of Massachusetts and not the cost of living figures published by the U.S.A. Bureau of Labour. The former have the great advantage that they appear regularly in the Federal Reserve Bulletin; whilst the latter only appear (at any rate in recent years) at infrequent periods. For anyone who is only interested in the *trend* of prices in this country and in the U.S.A. the Massachusetts figures will serve as well as the Bureau of Labour figures; but in the discussion as to the degree of *over- and undervaluation* of the pound sterling, the absolute height of the cost of living in the U.S.A. is a factor of some consequence.

Table I. brings out the situation for the three years before 1925 and throws some light upon the situation in the latter year itself. So far as the direct effect upon wage rates goes, the table shows (using Professor Bowley's wage-index)

Ds

that with practically the same rate of exchange in March, 1924, as in the first quarter of 1922, gold wages fell from 190 to 155 in that month; whilst the gold cost of living in this country fell in the same period of time from 164 to 157. During the same period of time real wages fell from 116 to 98. From March, 1924, to December, 1925, gold wages rose from 155 to 180, or 16%; real wages rose from 98 to 102, or some 4%; the gold cost of living rose from 157 to 177, or 12½%.

§ 16

If one asks, how far did the exchange equalise conditions between sterling prices and dollar prices, the answer turns on the dollar prices chosen. The table shows that if the ratio between British prices and American prices is based upon the Bureau of Labour figures, the exchange accurately, or almost accurately, compensated for the higher cost of living here during 1922, leaving a very slight margin in favour of British prices. In that year the purchasing parity theory worked very well.

The table also shows that, beginning after the first quarter of 1923, when the exchange completely equilibrated the two price-levels, the margin in favour of British prices, allowing for the exchange, continually increased, until in June, 1924, the margin was 13% in favour of this country. The pound was, therefore, undervalued, and progressively undervalued, and the

period was, significantly, marked by a fall of the trade union index of unemployment to its minimum. After the middle of 1924 the rise in the exchange gradually wiped out the undervaluation of the pound in terms of dollar cost of living figures, and, during 1925, the two sets of figures, at the current rates of exchange, were at par.

If the Massachusetts cost of living figure is taken, sterling cost of living and dollar cost of living were never adjusted by the exchange. Or, in other words, sterling was never quoted low enough in terms of dollars to bring sterling cost of living down to the level of New England, except in June and September, 1924. But the degree to which the pound was overvalued (on this basis) varied; in the periods during which, on the basis of the Bureau of Labour index, the undervaluation was greatest, the overvaluation was least. During the year 1925, when, on the basis of the Bureau index, the pound was neither over- nor undervalued, the Massachusetts index gave an overvaluation of the pound of between 8-10%. But it is, of course, extremely improbable that the Massachusetts index should be fully representative of the absolute height of the cost of living in so vast an area as the United States. The probability is that the true facts, so far as the cost of living in the U.S.A. is concerned, are more fully pictured by the Bureau index.

TABLE I

Date	Sterling Cost of Living	Rate of Exchange	Gold Cost of Living in Britain	American Gold Cost of Living	Massachusetts Gold Cost of Living	Ratio of American Cost of Living to British	Ratio of Massachusetts Cost of Living to British	Trade Union Index of Unemployment	Weekly Wage Index	Gold Wages Index	Real Wages Index
1922		\$									
1st Qr.	185	4.31	164	167	153	101	93	16.5%	215	190	116
2nd Qr.	182	4.44	166	167	152	100	91	16.4%	202	183	111
3rd Qr.	179	4.44	163½	166	152	101	93	14.5%	189	173	106
4th Qr.	179	4.51	166	170	154	102	93	14.1%	179	166	100
1923											
1st Qr.	176	4.68	169	169	154	100	90	13.0%	177	170	100
2nd Qr.	169	4.63	160	170	156	106	97	11.2%	177	169	104
3rd Qr.	173	4.56	162	172	157	106	97	11.3%	174	163	100
4th Qr.	176	4.42	160	173	158	108	99	10.4%	173	157	98
1924											
Mar.	178	4.29	157	170	154	108	98	7.8%	176	155	98
June	169	4.32	150	169	154	113	102	7.2%	178½	158	100
Sept.	172	4.46	158	171	157	108	100	8.6%	179	164	104
Dec.	181	4.69	174	173	158	99	90	9.2%	179	173	94
1925											
June	172	4.86	172	174	159	101	92	12.3%	181	181	105
Dec.	177	4.85	177	178	165	100	93	11.0%	180	180	102

½ Excludes Building Trades from this point.

§ 17

If we take these as the basis of the argument, what is the result? From the immediate angle of competitive efficiency it makes no difference whether the movements of the exchange have resulted in an overvaluation of the pound by a given amount, or whether the movement has merely resulted in wiping out an undervaluation of the pound of a similar amount. If the dollar cost of buying a given amount of services in the country has risen by 10%, under either contingency the competitive selling power of the country has declined, unless the buying power of the dollar over labour or services in the United States has fallen during the same period of time by such an amount as to leave the original ratios between the purchasing power of the dollar here and in the United States unchanged. Between June, 1924, and December, 1925, the purchasing power of the dollar in terms of the American cost of living index fell by 4.7% ; in this country the purchasing power of the dollar in terms of the cost of living index fell by 18%. The 13% greater purchasing power of the dollar here has been converted into a parity between what a dollar will buy in the States and what it will buy in Great Britain, in both cases in terms of the cost of living index.

What these figures do indicate is that that particular line of argument which asserts that at the beginning of 1924 the higher sterling cost of

living was just compensated by the exchange, and that since then sterling has been overvalued in proportion to the rise in the dollar value of sterling, is incorrect.* It is true only on the assumption that the Massachusetts index is a better guide to the internal value of the dollar than the Bureau of Labour index, and even in that case it is only true for that particular month. And it is also true that if the exchange had been pegged at, say, \$4.30 in March, 1924, and the British and American cost of living indices had not been affected in any way, but had behaved with a pegged exchange as it did behave whilst sterling was rising from \$4.29 to \$4.86, then the degree of undervaluation would have risen from 8% to 14%, and this, no doubt, would have stimulated exports and reduced unemployment. But this is, of course, a very extreme assumption to make.

§ 18

The immediate politico-economic problem of price-reduction remains unchanged by this analysis. From the standpoint of economic theory, however, the nature of the problem alters somewhat. The normal assumption is that the exchange now overvalues sterling; what appears to be the case is that the exchange has now ceased to undervalue sterling.

When the market rate of exchange undervalues a currency, this, in the absence of special factors, implies an involuntary and temporary alteration

in the real ratio of interchange which, in itself, by checking imports, helps to raise the exchange rate to purchasing power parity point. But if the real ratio of interchange itself alters, then no such improvement in exchange rates will follow, unless the price-level alters more than in proportion. From the standpoint of a country, then, which is trying to force exports, it makes no difference whether the alteration in the ratio of real interchange to its disadvantage is expressed by a fall in exchange below purchasing power parity point, or whether, exchange not falling, the prices of its export goods fall.¹ In either event, if foreign prices remain unchanged, a given volume of imports must be bought with a larger (real) volume of exports. It is true that the inelasticity of demand for foreign goods—or the elasticity of the foreign demand for exports—is not fixed once and for all, so that it does not follow that a given degree of undervaluation or (relatively) lower prices for export goods must persist.

Now it is at least significant that the undervaluation of the pound (on the basis of the relative cost of living indices) should have become marked—after a period of adjustment—in 1923. For in that year the payments on the American debt began.

¹ Which of these alternatives will happen will depend on whether the exchanges are controlled or on whether trade unions and other organisations are controlling costs. No line of distinction can be drawn ultimately between exportable and non-exportable goods, but only between goods actually exported and those which might be exported. It follows that variations in exchange in themselves modify the nature of imports and exports, and, through this, the ratio of exchange between all the products of a nation's industry. Thus changes in the ratio are the causes of later modifications in the ratio.

The question whether fixed payments of this kind must imply a permanent depression of the British price-level—for the exchange is now fixed—depends on the elasticity of demand for British products and on the elasticity of demand in Britain for American products. The gradual increase in world productivity should help to decrease both our dependence on American exports and our dependence on America as a market, or our dependence on markets whose demand for goods in general fluctuates with the demand in America for their special products. On the other hand, since 1923 the inelasticity of the demand for British coal and iron and steel goods, which was a special feature of the situation during the Ruhr occupation, has become less. Thus it is not easy to foresee how changes in the real ratio of international interchange is likely to affect the price position in the long run. The immediate situation is hardly likely to be greatly affected.

§ 19

The situation since the beginning of 1925 is set forth in the following Table II.

TABLE II

Month *	Unem- ployed Males	Trade Union Index of Unem- ployment All Trades	Males Unem- ployed % of estimated No. Insured	British Cost of Living Index	British Gold Cost of Living	Massa- chusetts Cost of Living	Ratio of Massa- chusetts to British Cost of Living	Wages Index (Bowdoy)	Gold Wages	Real Wages
1925										
January ..	1029	9.0	11.9	180	177	158	90	180	177	100
February ..	1043	9.4	12.1	179	176	157	90	181	178	101
March ..	1030	9.0	11.9 ¹	179	176	158	90	181	178	101
April ..	1015	9.4	11.7	175	172	158	90	181	180	103
May ..	1026	10.1	11.8	173	173	158	90	181	181	104
June ..	1134	12.3	13.0	172	172	159	92	181	181	105
July ..	1027	11.2	11.8	173	173	160	92	180	180	104
August ..	1141	11.4	13.1	173	173	161	93	180	180	104
September	1153	11.4	13.3	174	174	161	92	180	180	103
October ..	1110	11.3	12.7	176	176	162	92	180	180	102
November	1066	11.0	12.2	176	176	162	92	180	180	102
December	1012	11.0	11.6	177	177	165	93	180	180	101
1926										
January ..	1060	10.6	12.1	175	175	164	93	180	180	102
February ..	1002	10.4	11.5	173	173	163	94	180	180	104
March ..	946	10.1	10.9	172	172	161	94	180	180	104
April ..	880	10.0	10.1	168	168	161	95	180	180	107
May ..	1317	13.2	16.2 ¹	167	167	159	95	180	180	108
June ..	1362	12.9	16.5 ¹	168	168			180	180	106
July ..				170	170					

¹ Exclusive of coal.

The main features of the situation can be resumed thus :

Date	Jan. 1924	Jan. 1925
June 1926—Rise in \$ value of £ stg. since	13%	1.5%
.. Fall in Board of Trade General Wholesale Index Number since . .	11.5%	14%
.. Fall in Board of Trade Food Index Number since	5.5%	4%
.. Fall in Board of Trade Materials Index Number since	15%	15%
.. Fall in U.S.A. General Wholesale Index Number since	nil	5%
.. Fall in Ministry of Labour Cost of Living Index since	5%	5%

	Jan. 1924	Jan. 1925	Jan. 1926	June 1926
Ratio of British Cost of Living Index to Wholesale Index	108	104½	114	116
Ratio of Massachusetts Cost of Living to British Cost of Living Index	90	90		95 (April)
Gold Wages	155	177		180

Between 1924 and 1925 the Board of Trade General Wholesale Index rose 6 points, but whilst this rise was taking place the American Index number rose 9 points. The rise in the General Number conceals a rise of no less than 15 points in the Food Wholesale Index and a practically stationary condition of the Materials Index. The fall in the Materials Index has thus been concentrated into a period of one year, whilst the major portion of the rise in the dollar value of sterling took place in the year previous. Over the whole period the fall in the General Index, the Materials and the Food Index

corresponds closely with the rise in the exchange, though the fall in prices and rise in exchange did not coincide in time.

The effect of the whole series of changes has been to widen the gap between the Wholesale and Cost of Living Indices. By June of this year wholesale prices were 46% above pre-war, the Cost of Living Index some 70% above pre-war. The rise in the cost of living and the rise in wholesale prices corresponded most closely in the early part of 1924 and in January, 1925. By the end of that year the disparity had widened to 10 points, and it rose to 16 points in February, where it has since remained. The cost of living has not, in fact, responded to the altered exchange situation by more than the amount by which world prices have fallen. Since wages have remained stationary since July, 1925, the net effect has been to increase real wages by 6%. Meanwhile, it is important to notice that the Ministry of Labour *Food Index* has fallen by 8½% (January, 1925, to June, 1926) against a fall of 13% in the Wholesale Food Index. Since food constitutes about 60% of the Cost of Living Index, this is equivalent to about 5% on the total index; the amount by which, in fact, the Cost of Living Index has fallen. The conclusion that money wages are still too high is inescapable; though the gap between the (lower) Massachusetts Cost of Living and our own Cost of Living Index has been narrowed by 5%.

§ 20

So long as the productivity of industry as a whole does not increase there is no justification for the rise in real wages. Even before the complications introduced by the rising exchange the Index of Production prepared by the London and Cambridge Economic Service showed that, except for the boom year of 1920, post-war production in the industrial groups covered by the index was some 10% below the pre-war average (1913 as base-year). This index does not include the engineering trades, woollen textiles, and other important groups, so that not too much can be built upon it. What evidence it does bring is at any rate sufficient to disprove the suggestion that only the return to the gold standard has made the wage problem acute, though undoubtedly the return to gold at the parity chosen has accentuated the wage problem.²

If sterling costs remain up, whilst sterling returns fall, the scale of production contracts; if the sterling cost to the foreign buyer goes up and his currency price-level does not go up in proportion, he buys less, and again the scale of production contracts. There is thus a decline in foreign trade and a decline in employment. To what extent has the return to gold affected

² The production index moved as follows:

1924.	1st Qr. . .	89.6	1925.	1st Qr. . .	91.5	1926.	1st Qr. . .	90.6
"	2nd "	86.6	"	2nd "	87.0	"	2nd "	89.9
"	3rd "	89.6	"	3rd "	81.2			
"	4th "	93.9	"	4th "	88.8			

These figures confirm the general impression that the second and third quarters of 1926 saw the worst of the crisis.

the volume of employment and the volume of foreign trade ?

§ 21

The lowest figure for unemployment among insured males was returned in May, 1924, when the number stood at 846,000. Of these, 38,000 were coal miners and 43,000 were iron and steel workers. In January, 1925, the number stood at 1,029,000; by May it had increased to 1,134,000. There was a seasonal increase in the autumn somewhat in excess of this figure, but by April, 1926, the total number was down again to 880,000. At the maximum in June, 1925, there were unemployed 313,000 coal miners, at the minimum in April, 1926, there were 97,000. Between the minimum of 1924 and the maximum of 1925 the number of unemployed miners rose by 275,000 and then fell by 216,000. It follows that the "others unemployed" rose from 808,000 to 821,000 in June, 1925, and fell from thence to 793,000 in April, 1926. The numbers unemployed in the iron and steel industry at the dates mentioned were 43,000, 62,000 and 48,000 respectively. The net unemployment among males, i.e., excluding iron and steel, at the dates mentioned numbered 765,000, 759,000 and 735,000 respectively. If the number of unemployed females be added, the unemployment totals, *in industries other than coal and iron and steel*, came to 1,006,000 in May, 1924, 1,031,000 in June, 1925, and 948,000 in April, 1926. A seasonal element is contained in the last figure.

If, then, the minimum of May, 1924, is compared with the maximum of 1925 and with the minimum so far reached of 1926, we get the following result :

(ooo's omitted)

	May 1924	June 1925	Sept. 1925	April 1926
Industries other than Iron and Steel (males)	765	759	799	735
Females	241	272	270	213
	1006	1031	1069	948
Coal	38	313	290	97
Iron and Steel	43	62	64	48
	1087	1406	1423	1093

The increase, therefore, at the time when the coal crisis was at its height was rather under 30% ; in September, 1925, it was rather over 30%. But it is as well to correct the ideas this is likely to create, by thinking of the effect on the aggregate number employed. * The total number employed, per cent. of the estimated number insured, fell from 90% in May, 1924, to 86.7% in September, 1925, or to 87% in June, 1925. The unemployed total increased by one-third, but the employed total fell by three and one-third persons in every hundred. This is, no doubt, a less dramatic way of looking at it, but it is another useful reminder of the circumstance that, before we could attribute "our industrial troubles" to the "monetary policy announced in the Budget," ten out of

every hundred insured persons were out of a job, and ninety out of every hundred had one.¹

§ 22

The improvement which took place later in the volume of employment is not, of course, evidence of the degree of adjustment produced by the working of economic forces unaided by extraneous circumstances. The improvement in the coal and iron and steel trades, and to some extent the improvement elsewhere, is in part the effect of the coal subsidy. This is, of course, the case to the extent that the subsidy allowed a fall in coal prices without a reduction in miners' wages. But one is not entitled to infer that if the coal subsidy had never been granted we should necessarily have been worse off than we were in April of this year. What probably have happened would have been a general strike in July, 1925, instead of in May, 1926, three or four months of very heavy unemployment, and reduced coal wages at the end of it. By this time we should be nearing the end of the trouble instead of being half way through.

The unemployment figures themselves show how largely the problem was one of the coal and iron and steel trades. The output of coal, which had been 267.12 million tons in 1924, fell to

¹ If one desires an index of working-class purchasing power some evidence may be furnished by the following formula:

$$\% \text{ Insured workers employed} \times \text{Estimated wage rates (Bowley)}$$

		Cost of Living Index						
This gives the following results:								
January	1924	..	..	87	June 1926	..	..	91
June	"	..	..	84	December	..	..	90
December	"	..	..	87.8	June 1926	..	..	89

244.42 millions in 1925, whilst coal exports fell from 81.75 million tons to 68.97 millions. Thus output declined by 23.7 million tons and exports by 12.8 million tons. Average f.o.b. prices fell continuously during the year, and continued to fall in the first quarter of 1926. This reduction is partly the effect of subsidised competition between different collieries in this country and international competition between this country and Germany, where also the coal industry has been going through a severe crisis. Pit-head stocks of coal in the Ruhr rose from 2.8 millions in January, 1925, to a maximum of 3.3 millions in May, and sank to 2.3 millions by December. The excess of exports of coal over imports also rose to a maximum in September. The British coal subsidy began in August. It is clear that a subsidised area, other things equal, can dictate prices in a competitive market. If the current argument is true, that the demand for coal in the neighbourhood of current prices is inelastic, then there is some reason for arguing that, without the subsidy international coal prices would be higher than they were before the coal strike upset the situation, so that in effect the difficulties of the coal industry in this country would have been less also. It is not implied that without the subsidy the coal industry would not have had grave difficulties to contend with or that the return to gold did not complicate the situation¹; it is only intended to show that

¹ See *Die Wirtschaftskrise der Frankfurter Zeitung*, 1926, Heft 11, p. 123.

² See, in particular, Sir Josiah Stamp's weighty "addendum" to the Report by a *Committee of Inquiry concerning the Coal Mining Industry Dispute*, 1926. Cmd 2478 of 1926, p. 21 et seq.

the net gain to the coal industry was perhaps less than appears at first sight. Pressure was evidently slackening at the end of the year, for the four quarters of 1925 and the first quarter of 1926 average export prices were 20.75s., 20.58s., 19.39s., 18.41s., and 18.2s., the reduction being least between the last two quarters.

§ 23

Pig-iron and steel production also fell off decidedly during 1925 as compared with 1924 and still more as compared with 1923, the production in the four quarters of these years and in the first quarter of 1926 being :

	0,000 tons							
	1923		1924		1925		1926	
	Pig Iron	Steel	Pig Iron	Steel	Pig Iron	Steel	Pig Iron	Steel
1st Qr.	174	214	192	228	172	194	160	213
2nd "	206	234	188	217	165	183		
3rd "	181	190	177	186	139	171		
4th "	182	211	175	190	147	191		
Total	743	849	732	821	623	739		

By the beginning of 1926 steel production was back to what it was in the first quarter of 1923 and the second quarter of 1924 ; pig-iron production was still depressed. It is, of course, very difficult to say what the position of this industry would have been had the coal subsidy not lowered coal prices. The falling off in the volume of the exports of iron and steel was, in 1925, less real than apparent, owing to the change in the price-level. Thus, whilst exports of "Iron and Steel and Manufactures thereof" were in value only 93% of those in 1924, they were

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98.3% of the 1924 exports in *volume*. Thus the *financial return* accruing from exports was less, assuming that the costs of the industry did not fall off in proportion, but it does not follow that the volume of employment fell off to the same extent; the volume exported is a better index in this respect than the declared values.

Another aspect of the iron and steel trade situation is the relation between imports and exports. In *volume*, imports increased 18% in 1925. On the basis of actual values, the excess of exports in 1925 was £44.4 millions as compared with £52.4 millions in 1924; or, in other words, the imports were 30% of the exports in 1924 and amounted to 35% in 1925.¹

It is notorious that, quite apart from the influence of exchange, the coal and iron and steel industries have been subject to special difficulties which would in any case have made their position an unpleasant one. The results given above are the combined effects of the improvement in the exchange, currency disorganisation in France and Belgium, the crisis in Germany, the fall of prices in the United States and the mitigating effects of the subsidy.²

	1923	1924	1925
Retained Imports in 000 tons were	1314	2420	2712
British Exports in 000 tons were	4318	2861	2781
Excess of Exports	3004	1481	1019
		1924	1925
Retained Imports in value were	.. ..	22.1	28.7
British Exports in value were .. ..	.. ..	74.6	68.2
Excess of Exports .. ..	.. ..	52.4	44.6

¹ These figures include crude iron and steel, semi-finished and finished goods. Over the four quarters of the year the excess of export was 224, 218, 225, 264 thousand tons respectively. Vide *Board of Trade Journal* 15th January, 1926.

§ 24

If one turns to Foreign Trade as a whole; one has necessarily to rely in the main on the calculations of the Board of Trade both as regards changes in the value and volume of our commerce and as regards the interpretation of the "Balance of Indebtedness." So far as the return to gold affects imports, its most important direct consequence may be held to be the effect it has had upon the volume of *competitive imports*. The following Table throws light on the Declared Value, the volume and the changes in value of the *Retained Imports* of "Articles Wholly or Mainly Manufactured" since the beginning of 1925.

	As declared	Value on basis of 1924 prices	Declared value in 1924	Changes in value	Changes in volume
1925				1924 = 100	
1st Qr. ..	72	72	58	100	124
2nd	86	91	66	94	132
3rd	61	65	73	94	90
4th	69	71	70	97	101
1926					
1st	71	75	58	95	130
(2nd	67	74	66	90	112)

The two classes of British exports most directly affected are the "Raw Materials and Articles Mainly Unmanufactured" and the "Articles Wholly or Mainly Manufactured." These two classes have moved as follows:

(1) RAW MATERIALS AND ARTICLES MAINLY UNMANUFACTURED

	As declared	Value on basis of 1924 prices	Declared value in 1924	Changes in value	Changes in volume
1925					
1st Qr. ..	24	26	29	92	90
2nd " ..	21	23	27	91	85
3rd " ..	19	21	24	95	90
4th " ..	21	25	26	80	96
1926					
1st " ..	20	25	29	80	86
(2nd " ..	11	14	27	79	52)

(2) ARTICLES WHOLLY OR MAINLY MANUFACTURED

	As declared	Value on basis of 1924 prices	Declared value in 1924	Changes in value	Changes in volume
1925					
1st Qr. ..	166	167	148	99	112
2nd " ..	147	143	153	103	93
3rd " ..	150	154	159	97	96
4th " ..	154	163	158	94	103
1926					
1st " ..	153	165	148	92	111
(2nd " ..	123	129	153	95	84)

The exports of the United Kingdom as a whole moved as under :

	As declared	Value on basis of 1924 prices	Declared value in 1924	Changes in value	Changes in volume
1925 1st Qr. ..	209	210	193	99	109
2nd " ..	184	182	195	101	94
3rd " ..	187	194	210	69	96
4th " ..	194	209	212	93	99
1926 1st " ..	190	207	193	92	107

These results are obtained by comparing changes in value and in volume, quarter by quarter, with 1924. The trade in raw materials exported was higher in the first quarter of 1924 than in the last; in manufactured articles was higher in the last quarter than in the first, as was also the case with exports as a whole. If, then, one compares the most favourable quarter of 1924 with the most unfavourable quarter of 1925 one can get some idea of the immediate influence exerted by the return to gold. Even in this case other factors co-operate; the influence of the 1925 Budget in stimulating imports of artificial silk and goods affected by the re-imposition of the McKenna duties must not be overlooked. Further, in the period January to June, 1925, the French franc lost 11% of its dollar value in New York, so that, even if no change had taken place in sterling, French exports to this country would probably have been stimulated and British exports to France have declined.

	1924 Most favourable Quarter	1925 Most unfavourable Quarter (on basis of 1924 prices)	Change in volume	1st Qr. 1926 volume
Retained Imports, Articles Mainly or Wholly Mfd.	58 (1st Qr.)	97 (2nd Qr.)	174	130
Exports, Raw Materials	29 (1st ..)	21 (3rd ..)	73	86
Mfd. Articles	159 (3rd ..)	143 (2nd ..)	90	104
U.K. Produce	212 (4th ..)	182 (2nd ..)	86	97

Thus, *in volume*, British exports of manufactured goods were, in the first quarter of the year 1926, above the level of the most favourable period of 1924; raw materials are still 14% below and exports as a whole 3% below. On the other hand, manufactured imports are 30% higher than they were at their minimum of 1924. All the export groups show a considerable degree of recovery from the worst period of 1925—the second and third quarters—and manufactured imports a considerable decline from the maximum figure in the second quarter of 1925, when the effect of the full return to the gold standard was accentuated by the rush of imports owing to the re-imposition of old, and the imposition of new, Customs duties.

§ 25

It is, of course, difficult to discuss what would have been the position of British exports had the return to gold not taken place and the exchange had been allowed to look after itself. It is, however, fairly obvious that the sterling values of exports would certainly have been no lower, and would probably, in important cases, have been higher than they are now. For, even if no change in wage-rates in the exporting industries has taken place, the value of imported raw materials has been lowered by the rise in exchange, and, to the extent that a given mass of exports contains re-exported war materials, to that extent

will the declared value fall, without any sacrifice being imposed upon the British manufacturer. The loss, if any, which is inflicted on the exporter consists in the rise in the foreign currency value of the wages and other domestic costs which he has to meet. Hence we may expect two groups of British exports to fall most in price; those whose selling price is largely determined by the cost of the imported raw materials out of which they are made; and those, whether made of foreign raw materials or not, which are subject to fierce international competition and the international demand for which is elastic.

Further, a higher price in terms of foreign currency may be in part offset by greater efficiency of production—i.e. a reduction in the sterling cost per unit of output, due either to intensified efforts by labour, to substitution of labour by machinery, or to a combination of these. Further, so far as the aggregate volume of exports is concerned, the higher cost in terms of foreign money may be in part offset by economies resulting from a decline in the quality furnished for a given demand-price. Such a substitution of a lower for a higher quality may be dangerous to the long-run interests of British trade; if, however, the margin in the quality of British exports and competing exports from other countries is a wide one, a certain reduction in this margin may take place without provoking dangerous reactions on the sale of British goods.

Lastly, it may be noted that where the price of

a product is controlled by a group of producers, it becomes possible to sell in different markets at differential prices and, therefore, to sell abroad at lower prices than in this country. So long as trade is absolutely free this policy is impossible as soon as the difference in price exceeds the double cost of transport. But in a good many cases we no longer have free trade and, even where there are no fiscal barriers, producers may exert an influence on the prices charged by wholesalers and retailers by price agreements and other such arrangements. The very fact that money-wages and, therefore, consumers' income, have not fully responded to the alteration in wholesale prices increases the temptation to fix differential prices for different sales-areas.

The extent to which the prices of given exports have adjusted themselves to the exchange, on the one hand, and the competitive position of given different groups of export industries on the other, are issues which cannot usefully be discussed simply in general terms. In the *London and Cambridge Economic Service Bulletin* for December, 1925, Professor Bowley gave a series of index numbers of prices of manufactured exports for the four quarters of 1924 and the first quarter of 1925, the basis year being 1913. During that period the exchange rose 13%. The percentual reduction or increase between the first quarter of 1924 and the third quarter of 1925 was, for the undermentioned articles, as under :

	Increase	Decrease
IRON AND STEEL GROUP :		
Cleveland pig iron	*	26% (market price)
Pig-iron (forge and foundry)		18%
.. (acid)		23%
Iron sheets over inch ..		10%
.. .. under		15%
Galvanized sheets		10%
Tinned sheets		12%
Wire		15%
Wrought iron tubes		11%
Wire manufactures		6%
Sewing machine parts		30%
Machine tools		2%
Boilers & boiler house plant		5%
Copper plate	3%	
Tin blocks	2%	
Electrical machinery	5%	
TEXTILES :		
Grey cotton yarn, unbleached		6.5%
.. bleached		4.5%
Piece goods, grey, unbleached		4.5%
.. .. white, bleached		no change
.. .. printed	3%	
.. .. dyed in piece	2.5%	
.. .. coloured cottons		2.5%
Finished thread	12%	
Wool tops	10%	
Wool yarn carded	7%	
Worsted yarn, combed and		
.. carded	8%	
Alpaca and mohair	1%	
Wool tissues	15%	
Worsted	22%	
Blankets	9%	
Carpets	5.5%	
Market price Egyptian cotton	37%	
.. .. American		28%
.. .. Australian wool		19%

These figures show, clearly enough, (a) that the price-reductions have been most severe in the iron and steel group, (b) that in general they tend to be less where labour costs form a larger

proportion of the total cost, (c) that in the woollen industry, in spite of a reduction in the price of raw material, export prices have risen, in some cases considerably, and (d) that the price of cotton raw material has risen in the Egyptian section and fallen in the American, whilst prices of exports show a smaller range of variation in price than the prices of the raw material, and that the magnitude moves with the degree of labour cost involved. The rise in woollen exports and the sharp fall in iron and steel corresponds closely with the picture of expansion and contraction in the exports of these particular commodities.

The fact that exports as a whole should expand somewhat is quite consistent with depressed conditions in particular industries. The figures given above refer to the third quarter of 1925, so that they are now nearly a year old. The woollen industry has notoriously been subject to specially adverse influences peculiar to itself: the competition of new products, changes of taste and the influence of the French exchange. Moreover, in particular cases a rise of price may indicate a more favourable trade situation in that *particular commodity*, and, in any case, a fall in the price of a raw material and a fall in the price of the manufactured article are certain to be separated by a gap—so that there may be a progressive adaptation, which is still continuing and which the figures quoted above only partly bring out.

§ 26

The figures relating to Net Imports, Exports of U.K. produce and the monthly visible Adverse Balance of Trade since the beginning of 1924 are set out in the adjoining Table. * Interest relates to the questions (1) what the tendency has been since the Return to Gold and (2) how the Excess of Imports has been financed.

The Table shows that the excess of imports rises to a maximum in the fourth quarter of the year—a seasonal phenomenon associated with the autumnal crop movements. But it is clear that in 1925 and 1926 the excess of imports is at a higher level than in 1924. The year 1924, again, shows a higher average level than the year 1923. The average monthly excess of imports for each quarter since 1923 has been¹:

	1923	1924	1925	1926
1st Quarter	21*	23	34	31
2nd "	11	22	34	34
3rd "	14	27	22	
4th "	26	42	41	
Monthly average for year	19	28½	33	32½ (half year)

*Change of Basis owing to separation of Southern Ireland.

The problem is to separate out the specific influences exerted by the return to gold. The abnormally high figures of the second quarter of 1925 are clearly affected by the fiscal proposals of the Budget as well as by the return to gold: the position in the second quarter of 1926 is

¹ Exclusive of Bullion Shipments.

IMPORTS AND EXPORTS, 1924-6

	1924				1925				1926	
	1st	2nd	3rd	4th	1st	2nd	3rd	4th	1st	2nd
	Qr.	Qr.	Qr.	Qr.	Qr.	Qr.	Qr.	Qr.	Qr.	Qr.
Total Imports	302	297	311	371	352	326	288	358	321	281
Re-exports	39	35	29	37	40	38	36	42	37	30
Retained Imports	263	262	282	334	312	288	252	316	284	251
Exports U.K. Produce ..	193	195	201	206	209	184	187	194	190	149
Merchandise Balance ..	70	67	81	128	103	104	65	122	94	102
Net Imports Bullion ..				1½		3	3			5
Net Exports Bullion ..	9	4	½		4			12		
Aggregate Balance	61	63	80	129½	99	107	68	110		107
Monthly Average (including Bullion)	20	21	27	43	33	36	32	33		36
Monthly Average (excluding Bullion)	23	22	27	43	34	34	22	41	31	34

clearly affected by the coal strike. Until the end of 1925 the embargo on capital exports also worked in the direction of diminishing exports and thus increasing the excess of imports.

On the assumption that "invisible exports" (*less* Balance of Government Expenditure abroad over Receipts, averaged for the quarters) were equally distributed over the year, the successive phases of the situation can be summarised as in the table on page 78 :

The table indicates that, since the second half of 1924, the balance available for disposal has shrunk. There was, in fact, no available balance to feed capital exports in the first half of 1925. In the second half of 1925 the balance available for disposal amounted to £28 millions. In 1924 a small surplus in the first part of the year went towards meeting a large deficit in the second half. Thus, if the country had had to meet the whole of its current liabilities it could have invested only some £30 millions in 1925 and some £60 millions in 1924. As it was, it invested some £230 millions in the two years : to the extent of £100 millions out of its own resources and to the extent of £130 millions by resale of the loans elsewhere, or by short period borrowing.

The conclusion, then, is that, on the face of it, in the last two years we have borrowed, in the shape of increasing foreign balances in London and in other ways, a sum of considerably over £100 millions. We have lent long £220 millions and borrowed short £130 millions. Thus we are still paying our way and adding to the sum

	Merchandise Balance	Bullion Balance	Net Balance	Invisible Exports	Balance Available for Disposal	Overseas Issues	Net Surplus or Deficit
1924							
1st Qr.	70	-9	61	97	+36	67	+3 †
2nd Qr.	67	-4	63	97	+34		
3rd Qr.	81	- $\frac{1}{2}$	80	97	+17		
4th Qr.	128	+1 $\frac{1}{2}$	129 $\frac{1}{2}$	97	-33	68	-84 †
1925							
1st Qr.	103	-4	99	103	+4	39	-39
2nd Qr.	104	+3	107	103	-4		
3rd Qr.	65	+3	68	103	+35	49	-21
4th Qr.	122	-12	110	103	-7		

†The joint figure is about £10 millions too great owing to the rounding off of the various group figures in the merchandise balance.

total of the national wealth, but at a diminished rate. It is, however, clear that the rate at which our short-period indebtedness grew during 1925 diminished as the year went on. The evil of short-period borrowing, if it is an evil, did not grow progressively worse.

It is, however, important to notice that in these estimates there is considerable room for differences of opinion. The "invisible exports" are, in fact, pure conjecture: and the estimates of the Board of Trade make no allowance for "capital transactions" other than those arising from the offer of capital in the London market. Moreover, it would appear that part of the current excess of imports represented repayments for goods sold in the past: how large a part this is cannot be known, though the *Board of Trade Journal* appears to give credence to the view that in the case of France alone the amount involved during 1925-6 was £15-£20 millions.

Contrary to what appears to be the general view, the "invisible exports" as a whole have not been falling but increasing in the last few years. The official view is that shipping earnings have declined, but income from abroad has increased. Some increase in the volume of the excess of imports is justified on this ground: and, in any case, the transfer of income through the growth of social services is likely to diminish the volume of our foreign investments in the future, leaving the excess of imports larger.

§ 27

The fact that a portion of the excess of imports has in the last two years been financed by short period borrowings raises what is perhaps the most contentious of all the issues associated with the return of gold, viz. the financial policy pursued by the Bank of England.

Two entirely different issues are involved: what the Bank should have done, and what it in fact has done since April, 1925.

Assuming that British prices were, in fact, too high in comparison with gold prices in the outside world, the Bank was faced with the question whether it should allow the maladjustment to continue or should bring it to an end as soon as possible. In order to bring the maladjustment to an end it had, in fact, the following alternatives:

(1) A stable Bank rate accompanied by a loss of gold which it would do nothing to stop. Since a fall in reserves is accompanied by a decline in market balances open-market rates would rise. In order to prevent borrowing at the Bank at a rate below the higher Market rate, Bank rate would be gradually raised.

Rising Bank rate with a stable exchange creates the difficulty, from the standpoint of a deflationist policy, that it attracts foreign balances and thus widens the margin between Bank rate and Market rate and checks the outflow of gold. Hence the rise in Bank rate must be accompanied by an "open-market" policy, designed to reduce

the volume of funds in the market to what it would have been if no foreign funds had come in.

In this way, the economic pressure exerted by higher rates for money, accompanied by a real reduction in the volume of funds, by a higher reserve ratio and/or smaller absolute reserves, reinforced by the psychological effects on industry of "cheap money" would force prices down. The price paid would be a temporary increase in the volume of unemployment.

(2) Or the Bank could gamble on raising prices elsewhere by encouraging the export of large quantities of gold, and replacing gold in the balance-sheet by securities. To make this policy work with a maximum chance of success the Bank should have pressed for an amendment to the Bank Act of 1844 in order to enable it to use the gold now segregated and held against its notes, most of which are in circulation and not in the Reserve of the Banking Department at all. The wisdom of this policy depends upon how large its available gold reserves are, how large the area over which the expelled gold is to flow, and how great, therefore, the expected rise of prices elsewhere will be, and what chances there are that its policy of gold export will be neutralised by a policy designed to counter its own, on the part of other Central Banks.

Maladjustment can, then, come to an end by the adaptation either of a policy designed to bring British prices more into line with those of other gold standard countries or by a policy designed to bring gold standard prices in the rest of the

world to the level of British prices. The latter is the more risky policy, since the gamble may be

TABLE A

	Net Gold		Bank Rate	Market Rate of Dis. 3 mths.	Margin	Federal Reserve Rate	Margin London and New York Open Mkt. Dis. Rates.
	Inflow	Outflow					
1925							
May	960		5	4.69	.31	3½	1.5
June	494		5	4.41	.59	3½	1.3
July	6842		5	4.43	.57	3½	1.3
Aug.		1072	4½	4.02	.48	3½	0.9
Sept.		2764	4½	3.79	.81	3½	0.3
Oct.		10278	4	3.42	.58	3½	0.1
Nov.		3561	4	3.90	.10	3½	0.4*
Dec.		2118	5	4.71	.29	3½	1.2
1926							
Jan.		507	5	4.86	.14	4	1.1
Feb.	1387		5	4.36	.64	4	0.6
Mar.		958	5	4.40	.60	4	0.7
Apr.		259	5	4.38	.62	4-3½	0.8
May	2661		5	4.46	.54	3½	1.1
June	928		5	4.27	.73	3½	

TABLE B

Monthly Averages							
	Public Deposits	Other Deposits	Total Deposits	Govt. Securities	Other Securities	Total Securities	Reserve
1925							
May	15	105	120	36	74½	110½	27½
June	12	113½	125½	40	73½	113½	37
July	14	118	132	39	76	115	36
Aug.	16	109	125	32*	70	102	39
Sept.	18	112	130	38	73	111	36
Oct.	10	106	116	31	73	104	31
Nov.	17	108	125	39	75	114	26
Dec.	11	127	138	55	81	136	20
1926							
Jan.	17	112	129	45	80	125	22
Feb.	18	107	135	47	78	125	23
Mar.	20	102	122	39	77	116	24
Apr.	14	102	126	41	68	109	25
May	19	104	123	43½	71	114½	27
June	13	118	131	45	75	120	29

unsuccessful: the former is the more unpopular policy, since it involves a temporary depression of trade.

§ 28

What did the Bank of England actually do?

The examination of Bank of England policy falls into three parts, viz:

- (1) The question of Embargo,
- (2) The so-called Open-Market Policy of the Bank of England,
- (3) Bank rate, gold movements and the movements of foreign balances.

(1) The Embargo on Foreign Issues was a perfectly "unofficial" censorship exercised by the Bank of England, originally adopted in 1924 with the view, so it was at that time said, of keeping the market clear for Reconstruction Issues. It was continued, however, until November, 1925, with the object, it is to be imagined, of preventing too great a strain on the exchanges at a time when the price situation, here and abroad, would have encouraged the export of gold. It had, in fact, no very marked success in this direction: for the autumnal pressure was sufficient, as Table A shows, to cause a net outflow of gold of nearly £20 millions. On the other hand, so long as the embargo could be maintained effectively, it made a higher Bank rate less necessary—the obvious remedy for an excess of issues beyond the market's capacity to absorb them. Thus the embargo played the same rôle in the policy of the Bank of England as the

rationing of credit did on the Continent : favoured borrowers paid a lower rate than they would otherwise have had to do. On the other hand, a check to foreign issues did not prevent private buying of securities, to which extent the embargo was ineffective, and to the extent that it was effective, it hampered the development of exports and was obviously quite inconsistent either with the maintenance of London as an international financial centre or with the principles of the gold standard. But the lifting of the embargo, if it was not to mean additional pressure, implied an increase in the price of accommodation. The rise of the Bank rate in December, though plainly influenced by other considerations also, was in part due to the removal of a censorship which was both unpopular and economically undesirable.

(2) Writing in the *Nation* on 6th February, 1926, Mr. Keynes ascribed the unemployment situation in Germany to the "remorseless working of the same beautiful and reliable technique by which Governor Norman had previously achieved a comparable figure in England." * This implies that the domestic credit policy of the Bank had been a restrictive one : not necessarily working by means of a high discount rate, but by means of a withdrawal of funds from the market by means of sales of securities. In the next month the Midland Bank, in its Circular for March-April, published an article entitled "Bank of England Monetary Policy," designed to show that the "banking figures over the ten months following

* *Nation*, February 6th, 1926, p. 686.

the return to gold provide at once a clear demonstration of the practical working of the policy of stability and a striking eulogy of the skill employed in its execution." So far from the Bank deflating, "it refused to be driven by panic into rigid adherence to some minimum reserve ratio and proceeded to buy investments or increase its loans to the market to the extent of the reduction in the reserve."

The argument of the article, that the object of the Bank has been to place a constant mass of credit at the disposal of the market, is supported by a detailed examination of the Bank's position at four distinct dates, spreading from 29th April, 1925, to 24th February, 1926. At those four dates deposits stood at £122 millions, though changes in the Reserve and in the Securities of precisely equal amounts had taken place: the net effect being that, over the whole ten months, Deposits were unchanged, the Reserve was down £4 millions and the Securities had increased by a similar amount.

The May, 1926, Banking Number of the *Economist* rather threw cold water upon this argument, implying that a balance-sheet must always balance and that the four dates chosen were insufficient to prove the point involved. Table B above does in fact show that, quite apart from the end of the year and the half-year when "window-dressing" notoriously affects Banking figures, the average monthly figures of the "Deposits" have fluctuated not inconsiderably. The important point is, however, this. The

Bank has not allowed movements in the Reserve to *dominate* the situation. Had it done so, Deposits should have fallen and risen with the Reserve. That they clearly have not done. Between May and August the Reserve expanded by £11½ millions, the Deposits by only £5 millions. Between August and November the Reserve fell by £13 millions: the Deposits remained unchanged. Between January and May, 1926, the Reserve rose by £5 millions: the Deposits fell by £6 millions, the rise in the Reserve being offset by twice as large a fall in the volume of securities. Thus, so far as the volume of banking accommodation is directly controllable by the Bank, it has pursued a policy of stabilisation, in the sense of maintaining in the market as far as possible a constant volume of funds.

(3) This very fact throws light upon the other elements in the policy of the Bank.

(a) With a constant volume of funds placed at the disposal of the market by the Bank the price of money will (directly) vary with the state of demand. If the margin between Bank rate and Market rate diminishes the Bank will be obliged to raise its rate. This will attract fresh funds from abroad, other things equal, and this in turn will cause the margin to increase. If the margin increases the Bank is in a position to reduce Bank rate, and will be able to do this the more easily the lower rates are in the lending centres from which funds are drawn.

(b) Given this constant volume of funds employed by the Bank, the variable element on the supply side of the market will be the volume of foreign funds employed. Manipulations of Bank rate and flow of foreign funds will be related to one another directly.

(c) Given, again, this policy of stabilisation of the volume of funds lent *by the Bank*, gold outflows must be treated as irrelevant *unless* the gold outflow coincided with a decline in the margin between Bank rate and Market rate *here*, and Market rate *here* and *abroad*. Gold outflow must then be treated as a sign, not of the Bank's own credit policy, but of the decline of foreign balances. The Bank rate must then go up. If the outflow of gold takes place at a time when the two margins widen, the Bank must take no notice.

If gold flows in at a time when the home margin is narrowing (as it did in May, 1926) that can only be because the margin between home and foreign rates is widening (as was also the case in May). If the Bank *then* reduces its rate, this, to be consistent, must only happen because subsequently the margin between Bank rate and Market rate *here* is widening, and *not* because the Reserve is increasing. The Bank rate must rise even if gold flows in, or the outflow of gold diminishes, if the home and foreign margin continues to narrow or does not widen. The Bank was thus quite consistent in raising the rate last year in December after a period of narrowing margin: from this

point of view the Bank would also have been justified in reducing the rate in May of this year, because with a narrowing margin here and a widening one, comparing London with abroad, the condition for an inflow of funds was present.

§ 29

One other element in the financial situation remains to be considered, viz. the extent to which the policy of the Bank of England has been furthered by the assistance of other Central Banks. There are two banks whose actions must be considered in this connection—the Federal Reserve Bank of New York and the Bank of the Netherlands.

The grant of a revolving gold credit of 200,000,000 dollars by the Reserve System to the Bank of England was the occasion of vehement criticism by various parties in the U.S.A.¹ In point of fact, the Federal Reserve Board, in approving the arrangements, was moved by the perfectly logical considerations that the re-establishment of the gold standard would be an important step in the direction of the restoration of monetary stability throughout the world, and that business and credit conditions in the U.S.A. itself would benefit therefrom. But this stabilisation credit has not been made use of. The support which the Bank of England has in practice been afforded consists in the rate policy pursued

¹ For the terms of the agreement, see *Twelfth Annual Report of the Federal Reserve Board*, pp. 12-13.

by the New York Bank in the autumn of 1925. Between 10th and 23rd November, 1925, those Federal Reserve Banks (other than New York) which had not already a 4% Bank rate raised their rate to this level, whilst the New York rate was kept at $3\frac{1}{2}$ %. Between August and October, 1925, the margin between open-market rates here and in New York had fallen almost to vanishing-point. Had the New York rate been raised, the margin in favour of London might have been changed into a margin in favour of New York.¹ By not raising the rate the New York Bank thus prevented the outflow of gold from this country being even heavier than it actually was, whilst the desire not to add to gold imports and to bring pressure on American business at a time of seasonal increase of demand for accommodation provided the official reasons for not taking steps which, had they been taken, would in fact have caused the Bank rate here to go up earlier than it actually did.²

That the spread in the money market rates has dominated the London-Amsterdam exchange during 1925 has been shown in detail by Mr. J. Greidanus.³ The point with which we are concerned here is the policy of the Netherlands Bank.

"The Bank assisted the Bank of England's gold policy by large shipments of gold to an amount of

¹ To what extent New York balances have been loaned on so-called "special terms" is, unfortunately, unknown. The margin between London and New York rates is not, however, an absolutely decisive test of the probable flow of funds.

² For the official explanation of the attitude of the New York Reserve Bank see *op. cit.*, p. 6.

³ *Die Geldmarkt in 1926*, *Ökonomisch Statistische Berichte*, 1926, pp. 130-2.

65 million florins between June and August, 1925; whilst the Bank also transferred to this country a portion of its American balances.¹ The assets of the Bank of England reached a total of £17½ millions, "a figure never before reached in the books of the Bank."

The maximum figure, it is to be noted, was reached after a period—October—November, 1925—during which gold flowed in large quantities to Holland. The quantity would probably have been larger still had not the Netherlands Bank followed the downward movement of Bank rate here. British Bank rate fell from 4½%, to which it had been reduced on 6th August, to 4% on 1st October. The Dutch rate fell on 3rd October, 1925, from 4% to 3½%.

The Reserve System has specifically denied that it has entered into any commitment with the Bank of England "as to the policies to be pursued by either bank in dealing with domestic credit conditions or with changes in discount rates."² The Report of the Netherlands Bank is silent on the subject of any arrangement with the Bank of England, but points out that its gold shipments were not "without importance for England" as they helped to disappoint those pessimistic opponents of the return to gold who had believed that the policy would be defeated by large gold withdrawals.³ Whether dictated by domestic considerations or not, the policy actually pursued by these two Banks was undoubtedly of importance in the first eight months of the restored gold

¹ *Verlag, Nederlandsche Bank, 1925-6*, pp. 4-5. ² *Report*, p. 13. ³ *Op. cit.*, p. 6.

standard. Later, after the turn of the year, conditions changed somewhat. In accordance with domestic credit requirements, the New York rate rose to 4% on 8th January, whilst in the first three months of the year 1926 the Netherlands Bank sold sterling freely in order to prevent the sterling rate from rising too much in Amsterdam, and thus prevented gold shipments from Holland.¹

§ 30

For its reliance upon the policy of encouraging foreign balances to flow here,² and thus keeping the exchange at par without a radical revision of the price-level here, the Bank has been severely criticised. There is, in fact, no difference, Mr. Keynes has argued, between (a) the policy of attracting foreign balances and the use of the emergency credits provided for when the gold standard was restored³ (and not, so far, made use of), and (b) between the policy of the Central Bank here and in France, because in both cases foreign money is being employed without any attempt at a radical revision of the internal situation.

The first argument is valid. The second overlooks the fact that if the Bank of England has not deflated, it has, at any rate, tried to prevent the maladjustment from becoming worse: that is, it has tried to prevent the inflow of gold from

¹ *Forslag*, p. 8. The Bank sold sterling to an amount of 60 millions of florins.

² *Economic Journal*, p. 203.

affecting the price-level by means of its open market operations. But, all in all, the Bank has fallen between two stools. It has not gained the support of the cheap credit school, and its policy cannot be supported by those who believe that the Bank ought to have restored equilibrium by allowing gold to go and prices to fall.

The argument against the use of Bank rate as a means of attracting foreign balances can be overstressed, however, if it is used to imply that all the foreign balances now employed in London are directly due to a higher Bank rate here than elsewhere. The funds placed here are, in fact, divisible into those which would be placed here in any case, those which are placed here in preference to some other foreign centre partly for the sake of convenience and partly for the sake of higher earnings, and those, finally, which are placed here only because London rates are higher. From the standpoint of Europe as a whole, given stability in rates of exchange, London is geographically more convenient than New York, and the return to gold in itself encouraged transfers from New York. *These* balances have been added to as a consequence of the flight from the franc and the lira. The group of balances which are directly influenced by movements in relative rates are thus only a part of a larger whole. If the campaign against "bad money" is interpreted as implying that the holding of foreign balances in London is to be officially discouraged, then, of course, the place of London as an international financial centre is at an end.

Some such conclusion is, in fact, implicitly contained in the logic of those who wish to pursue a nationalistic monetary policy, to the tune of "looking after the price-level and letting the exchanges look after themselves."¹

*§ 31

If recent controversies have done nothing else, they have at least shown the impossibility of a managed currency. The whole of the present controversy turns upon the comparatively simple issue of the relative advantages of two possible gold parity levels, and upon the consequences of choosing one of these in preference to the other. In the course of the last year and a half the opponents of the gold standard have succeeded in doing what in the end must prove fatal to their own much more ambitious policy: they have identified currency policy with political personalities. If only Mr. Churchill had never gone to the Treasury! If only "Queen Baldwin" could be taught elementary economics! If only the Micawbers of the City, living in the atmosphere of hoping for something to turn up, could be deposed in favour of the Cromwells of the *Nation* office!

The ease with which a campaign can be worked up and exploited, scepticism and ill-will generated and class-bitterness deepened, is shown, by the campaign which Mr. Keynes has so brilliantly led. The fact that Mr. Keynes cannot be held

¹ *Economic Consequences of Mr. Churchill*, p. 16.

responsible for the wilder arguments of the anti-gold school, or for the ludicrous hopes which are held out as likely to result from its abolition, is beside the point. The point is that the present campaign proves, once and for all, that a currency policy which would require constant manipulation to be successful would maximise the chance that its working would be distorted by political prejudice. Mr. Keynes and his followers have tried to kill the currency policy of the present Government: by identifying currency policy with presumed class-interests Mr. Keynes has taught all politicians a lesson which they are not likely easily to forget.

§ 32

The *logical* case against the "return to gold" is not, of course, affected by the circumstances and considerations set forth above. But the case against the return to gold cannot be discussed merely by proving, or attempting to prove, that some of the short-run consequences have been unpleasant; they may be worth while, on balance, even if contrasted only with short-run gains; still more if contrasted with long-run gains. As I have attempted to show in the theoretical section which precedes, and in the international survey which follows, this section of the pamphlet, the process of adjustment and stabilisation must expose the national economic organisation which is subjected to it to a certain degree of shock. That shock may be greater or

less, may occur sooner or later, according to the mode of adjustment adopted : it is the price which a particular economic society pays for having cut itself adrift from the world movement of prices and from a world standard of currency. The great and overwhelming merit of the gold standard is just that it implies a world-level of prices, and that, in consequence, changes in the position of classes and individuals, so far as they result from changes in prices, cannot be so easily attributed to the vagaries of particular politicians. But this does not decide the issue whether we ought not to have devaluated rather than have insisted upon the old par of exchange. Two powerful streams of sentiment could be utilised against either alternative : the fear of wage reductions against the one, the fear of loss of international financial prestige against the other. The final test of whether we have chosen the right alternative depends upon whether or not it will be possible to adjust wages to the new scale of international values. One opportunity of a revision of general wage rates was missed at the end of the general strike. Some modification of the inelasticity of trade union structure and of wages should then have been undertaken : not, of course, by individual employers fighting individual trade unions, but as part of a negotiated peace between the Government and the trade union movement as a whole. That opportunity was not taken, and it is not likely to recur. There remains only the method of particular wage reductions in particular industries ; a process already going on in the

unsheltered trades, and which is overdue, on grounds with which the gold standard has nothing to do, in the sheltered trades:

Of course, supporters of the gold standard, or, rather, of the old parity, have to be prepared to face what odium attaches to the assertion of a belief in the necessity for a reduction of money wages—at any rate, in such trades or services as are not directly influenced by the international price movement. At any rate, if the arguments previously set forth are correct, they will have the consolation that under no monetary standard, not even a paper one, is the adjustment of relative wages to one another, and of wages as a whole to other price-indices, so automatic that, on general social grounds, the gold standard is to be rejected with derision.

(2) STABILISATION POLICY IN SCANDINAVIA

(a) Sweden

§ 33

The Swedish gold standard was resumed at the old parity of exchange—3.73 Swedish crowns to the dollar—on 1st April, 1924, the only modification being that gold imports were made a legal monopoly of the Central Bank. At that time neither wholesale prices nor cost of living figures were equilibrated with those of America, but the situation had been much modified in the course of the years immediately prior to the resumption of gold payments.

Date	Swedish Cost of Living	Dollar Rate, cents	Gold Cost of Living in Sweden	¹ Bureau of Labour Cost of Living	² Relative Wholesale Prices	³ Relative Cost of Living in Sweden	Unemploy- ment Index in Sweden
1921							
January	271	21.0	212				34.9
April	249	23.4	217	180			30.4
July	236	21.0	186	177			27.9
October	231	22.9	197	174			27.1
1922							
January	216	25.0	201	167	131	07	34.3
April	195	26.1	190	167	122	103	28.3 ²
July	190	26.0	184	166	112	103	18.2
October	190	26.7	189	170	104	101	15.5
1923							
January	183	26.0	183	169	104	100	20.5
April	177	26.7	176	170	106	101	14.9
July	174	26.6	172	172	107	101	9.1
October	177	26.4	174	173	105	101	8.2

¹ Quarterly figures, and, therefore, not strictly comparable with Swedish figures.

² From *Memorandum on Central Banks, 1921-4*.

³ From this point the unemployment figures are taken from the *Swedish Economic Review*: the earlier figures from the *Swedish Labour Gazette*: the two sets of figures are not comparable, as the former appear to allow for seasonal variations (?).

It is clear, from the above table that, during 1921 and 1922, when the gold cost of living was highest in Sweden relatively to the United States, the exchange had not succeeded in adjusting the two price-bases, and that the Swedish crown was seriously overvalued by the exchange. Unemployment also tended to be higher, the greater the disparity in the two. By the end of 1923, however, the disparity on cost of living basis was almost, if not completely, eliminated. The Swedish crisis had, therefore, been gone through *before* the return to gold, instead of after the return.

The position in 1924 itself and in the subsequent period is summarised in the table on page 99.

It will be noted that the Swedish exchange was not at par when gold payments were resumed. Par with the dollar was not reached till November, 1924: the Swedish crown was at a premium between December, 1924, and April, 1925, and has since been fluctuating narrowly within the neighbourhood of par. How has purchasing power parity been affected? The relevant figures are:

	March 1924	June 1924	Sept. 1924	Dec. 1924	June 1925	Sept. 1925	Dec. 1925
Swedish cost of living in crowns	173	171	174	178	176	175	174
Swedish cost of living in dollars	170	169	172	179	175½	175	174
American cost of living	170	169	171	173	174		178

Date	U.S.A. Cost of Living	Swedish Cost of Living	Notes Circulation	Bank Rate	Unemployment (Percentage of workers unemployed among Trade Unionists)	Rate of Exchange		Wholesale Prices
	July, 1914 = 100	July, 1914 = 100	Million Kronor	%		New York Par 2.73 Kr. = 1 \$	London Par 18.16 Kr. = £	
1923 December	173	176				Kronor	Kronor	
1924 January			509	5	13.6	3.79	16.28	161
February			523	5	13.2	3.80	16.46	162
March	170	173	557	5	13.9	3.79	16.34	162
April			522	5	11.5	3.79	16.50	161
May			523	5	7.6	3.77	16.46	160
June	169	173	557	5	7.4	3.76	16.28	158
July			515	5	6.2	3.76	16.43	157
August			528	5	6.6	3.76	16.91	157
September	171	174	564	5	7.0	3.76	16.78	160
October			536	5	8.4	3.76	16.86	163
November			537	5	10.5	3.73	17.19	167
December	173	178	437	5	15.5	3.71	17.42	168
1925 January			583	5	14.8	3.71	17.74	169
February			493	5	13.5	3.71	17.71	169
March		177	521	5	12.0	3.71	17.73	168
April			493	5	10.9	3.71	17.80	163
May			500	5	7.8	3.74	18.15	162
June	174	176	523	5	8.2	3.74	18.16	161
July			494	5	7.6	3.73	18.11	161
August			511	5	7.7	3.72	18.08	159
September		175	551	5	8.5	3.73	18.07	157
October			523	4	10.0	3.74	18.08	154
November			522	4	11.8	3.74	18.12	155
December	178	174	530	4	19.4	3.73	18.11	156
1926 January			475	4	15.7	3.74	18.14	153
February			489	4	14.8	3.74	18.16	152
March	173	173	527	4	14.7	3.73	18.13	149
April			498	4	12.3	3.74	18.15	150
May			489	4	9.7	3.74	18.16	151
June	100	172	528	4	9.5	3.73	18.12	150
July			494	4		3.73	18.16	

Thus, up to September, 1924, the fact that the Swedish exchange was above par reduced the dollar cost of living to the American level; when the Swedish crown rose above par it raised the Swedish cost of living 3-4% above the American level. By the end of 1925, though the Swedish crown was at par, the Swedish cost of living was 3% below the American. This analysis confirms the view of Professor Cassel, based upon wholesale price indices, who, writing at the beginning of 1925, expressed the view that "it must be supposed that the present rate of exchange, about $\frac{1}{2}$ % above par, shows some overvaluation. . . . There is every reason to contend that the Swedish krona with reference to its internal purchasing power in relation to that of the dollar ought now to be somewhat below its gold par."

It may also be noted that the tendency for the ratio of cost of living prices to wholesale prices to widen is present in Sweden also. In March, 1924, the ratio was 107—that is, the rise in the cost of living figures was 7% more than the rise in wholesale prices. By March, 1926, the relationship was 100:116. This widening in the ratio is the same, or almost the same, as that in Great Britain, and appears to be having some effect upon the level of employment.

The return to the gold standard was not accomplished without pressure on the reserves of the Central Bank. The total stock of gold and foreign exchange fell from 384,000,000 Swedish

¹ "Sweden's Experience of the Gold Standard" in *Quarterly Report of the Sveriges Bank*, No. 1 of 1925. See also *Times Banking Number*, May, 1925.

crowns in January, 1924, to a minimum of 316,000,000 in May. To relieve the pressure not inconsiderable emergency credits were arranged in New York (25,000,000 dollars in May, renewed for twelve months in May, 1925), together with short-term discounting of Treasury bills (20,000,000 dollars repaid in September and October, 1924) and a long-period loan on behalf of the State. The position of the Swedish Central Bank was, however, complicated by the fact that, exceptionally, gold was cheaper in Stockholm than in London. Whether the rise of the Swedish crown above parity at the end of the year was the result of deliberate policy to check this special drain, or whether it was due to a temporary cheapness of the dollar, "is a matter which must be left open."¹

(b) *Norway and Denmark*²

§ 34

The essential facts in the Danish and Norwegian situation are simple enough. Within a period of two years the exchange has risen so rapidly that the gold cost of living, which during 1924 was still markedly below the American level, had by the end of 1925 risen to a parity with the American in the case of Norway, and was somewhat above the American in the case of

¹ *Camel*, loc. cit., p. 2.

² For details of reports, *Memorandum on Central Banking, 1923-4*, and current *Bulletins of the Swiss Bank Corporation*.

Denmark. In the Danish case the rise is a continuous one: in Norway the deviation was greater in September than it was subsequently, because between September and December the exchange was allowed to fall, and the cost of living also fell 13 points. In 1926 the cost of living has continued to fall and the exchange to rise, and the gold cost of living has risen somewhat. In both countries the turn of the year was marked by very heavy unemployment, partly seasonal in character, but clearly in part due to the maladjustment of prices and exchange.

The causes of the situation are well known. In July, 1924, there was created a Monetary Advisory Committee in Denmark, which reported on 5th November. It decided that the time had not yet come definitely to decree the devaluation of the currency, but that everything should be done to stop the depreciation of the Danish crown. The minimum value, below which the Danish crown was not to be allowed to fall, was 65 ore gold for 1 crown paper, and the dollar was to be maintained at this figure (17.4 American cents to the paper crown). The Committee thought that this rate ought to be maintained up to 1st July, 1925. After this date the price of the dollar should be reduced during the three following quarters in such a way that the gold value of the crown should progressively increase, on a scale the details of which should be fixed by common accord between the National Bank and the Finance Ministry.

This was, it will be noted, a plan based on the

celebrated British Resumption Act of 1819, by the terms of which, also, the gold value of the pound was to be gradually raised. An Act based on this idea was ratified on 20th December, 1924. Inconvertibility of the note was maintained till 31st December, 1926. The dollar was to be maintained at 5.74 Danish crowns in the first half of 1925; at 5.60 crowns in the second half of 1925; at 5.46 crowns up to July, 1926; and at 5.32 crowns up to December, 1926. These rates correspond to 17.4, 17.8, 18.3, and 18.8 American gold cents to the paper crown.

In the first half of 1925 the actual rates fell somewhat below the rates thus fixed, but the actual development quite outran expectations in the second half of the year. Speculation, anticipated the future, and by the end of the year the actual market rate was very near parity (34.864 cents; par 26.799 cents). The Central Bank did attempt to check the rise by lowering its discount rates from 7 to 6, and then to $5\frac{1}{2}\%$, but by May, 1926, the market rate of 26.202 cents was only 3% from parity. At the end of 1925 the gold cost of living was 2 points above the American. The exchange thus overvalues the crown, but not, presumably, very much: though the volume of unemployment indicates the severity of the recent crisis, and would seem to show that wage rates are too high. Hourly wage rates in Copenhagen at the beginning of 1925¹ were, as compared with 1913:

¹ Taken from *Die Weltwirtschaftliche Lage Ende 1925*, Berlin, 1926.

Date	Kr. per hour				
	Bauklayers	Unskilled Workers			Compositors
		Building trades	Engineering trades	Printing trades	
1913	0.86	0.615	0.485	0.571	0.78
1925	2.76	2.12	1.51	1.59	2.08
	321%	375%	308%	280%	266%

The cost of living was about $2\frac{1}{4}$ times what it was in 1914. If wage rates have not since fallen, it is clear that, with cost of living and exchange at their present levels, Danish labour costs must be very high.

In Norway a Commission of seven was appointed in mid-September, 1925, to investigate the position of the exchange. The Bank of Norway at the same time announced that its efforts were directed towards a slow amelioration of the value of the Norwegian crown. But speculation and credit-restriction had already driven up the exchange by 33 $\frac{1}{2}$ % from the beginning of the year, and the gold cost of living had mounted by some 23%. The Committee reported in January, 1926, arguing that there was no practical interest in raising the rate progressively up to par, and that actual financial and economic conditions permitted neither the establishment of a programme for the definitive resumption of gold payments nor the attainment of the old parity. On the other hand, the stabilisation of the crown at approximately the actual rate of

Date	From Monthly Bulletin of Statistics of L. of N.	From the Bulletin of the International Institute of Statistics	Million kroner	%	(Percentage unemployed among Trade Unionists)	(Parity 26,799 cta. = 1 krone)	Living in Norway on basis of L. of N. figures
1924 January			365	7	9.1	14.092	
February			369	7	8.2	13.339	
March	249	244	360	7	12.0	13.572	126
April			380	7	7.6	13.806	
May			379	7	6.1	13.882	
June	251	245	395	7	4.9	13.524	126
July			390	7	9.1	13.441	
August			390	7	4.0	13.854	
September	260	258	389	7	5.2	13.847	133
October			386	7	6.7	14.258	
November			376	6½	8.2	14.724	
December	267	266	391	6	12.5	15.074	150
1925 January			361	6	11.9	15.271	
February		283	368	6	12.0	15.254	
March	273	271	380	6	11.1	15.435	157
April		276	380	6½	10.2	16.134	
May		265	374	6	9.5	16.820	
June	261	259	387	6	8.9	17.012	165
July			384	6	8.3	18.067	
August			378	5½	10.1	18.803	
September	249	248	372	5	13.5	20.932	194
October		241	367	5	16.4	20.204	
November		236	351	5	19.0	20.313	
December	236	234	363	5	23.7	20.312	178
1926 January		232	335	6	23.4	20.349	
February		230	330	6	24.2	20.827	
March	227	225	350	6	23.4	21.467	182
April		221	343	5½	25.0	21.618	
May		220	335	5½		21.657	
June	218		343	5½		22.103	180
July			340	5½			

1 Figures from the League of Nations' Monthly Bulletin of Statistics except where otherwise stated.

DENMARK 1

Date	Cost of Living	Note Circulation	Bank Rate	Unemployment (Percentage unemployed among Trade Unionists)	Krone in New York	Gold Value of Cost of Living
	July 1914 = 100	Million kroner	%		(Parity 26,798 cta. = 1 krone)	
1923 December	209					
1924 January		446	7	21.0	16.942	
February		450	7	21.3	15.998	
March		463	7	16.7	15.679	
April		469	7	9.3	16.645	
May		481	7	6.2	16.924	
June	214	477	7	5.0	16.778	
July		470	7	5.3	16.047	134
August		471	7	5.4	16.212	
September		473	7	5.8	16.946	
October		495	7	6.5	17.333	
November		479	7	9.4	17.548	
December	221	478	7	17.1	17.636	145
1925 January		456	7	16.9	17.810	
February		453	7	16.8	17.806	
March		452	7	14.7	18.069	
April		465	7	13.3	18.440	
May		467	7	12.1	18.808	
June	219	468	7	9.1	19.114	157
July		449	7	8.3	21.366	
August		442	6	9.7	23.302	
September		430	5	10.6	24.519	
October		454	5	13.5	24.577	
November		434	5	20.5	24.856	
December	194	438	5	31.7	24.864	180
1926 January		403	5	30.1	24.804	
February		399	5	27.5	25.379	
March		411	5	21.4	26.113	
April		411	5	16.6	26.174	
May		400	5	15.6	26.202	
June	184	401	5	16.3	26.485	182
July		380	5		26.502	

exchange could be undertaken with success, and the Committee therefore recommended that the Bank of Norway should engage itself to maintain the value of the dollar to be as near actual rates as possible, with a determinate maximum and minimum. In June, 1926, an Act was passed by which the Norwegian Government concluded an agreement with the Central Bank, destined to reinforce control by the Bank over the exchange value of the Norwegian crown, and especially to prevent speculation.

Obviously the best way to prevent speculation is to fix a definite rate. At the end of 1925 the gold cost of living was at par with the U.S.A., so that a rate in the neighbourhood of 1 krone-20-21 cents should not overvalue or undervalue the currency unduly. But, as in the case of Denmark, the level of money wages may be out of touch with wholesale prices and the cost of living.

(3) STABILISATION POLICY IN CENTRAL EUROPE

(a) *Holland*

§ 35

The position up to the end of 1923 is set forth in the table on page 108.

During 1920 and 1921, then, the American cost of living was higher than the Dutch, though the disparity had almost disappeared by the end of the latter year. The year 1922 marks a year in

82

Date	Golden Prices (Cost of Living)	Rate of Exchange (Parity 40.198 cts. = 1 gulden)	Gold Cost of Living	Unemployment %	American Cost of Living	Ratio of American Cost of Living to Dutch
1920						
March	214	36.4	194	6.4		
June	219	36.0	196	5.0	217	110
September ..	228	31.3	177	3.3		
December ..	222	30.4	168	10.2	198	118
1921						
March	210	34.3	179	11.3		
June	208	33.7	174	6.6	180	103
September ..	199	31.7	154	5.6	177	115
December ..	191	36.3	172	13.7	174	101
1922						
March	192	37.9	186	12.0	167	90
June	187	38.7	180	8.1	167	91
September ..	175	38.8	169	8.0	166	98
December ..	176	39.8	174	13.4	170	98
1923						
March	173	39.5	170	11.9	169	99
June	174	39.2	168	8.2	170	101
September ..	173	39.3	169	10.0	172	102
December ..	178	38.0	173	13.7	173	100

which the Dutch cost of living, equilibrated with the American through the rate of exchange, is higher than the American, though again by the end of the year there is no disparity. It is interesting to observe that during this year the level of unemployment, though affected by an obvious seasonal factor, does not fall to the same minimum levels as in the two previous years. In 1923 there is practical coincidence between the two costs of living, but unemployment remains at a high level; though this is, no doubt, to be ascribed primarily to conditions in the Ruhr and Germany generally, and not to currency questions.

Conditions in 1924 and 1925—Holland returned to gold simultaneously with this country—are summarised in the table on page 110.

During 1924 the exchange at first undervalued and then overvalued the Dutch florin on a cost of living basis. Unemployment falls to a minimum of 5.8 in June, and, though it rose seasonally at the end of 1924 (coinciding with the period of overvaluation), it did not touch again the high level of January, 1924. The favourable development in Germany was clearly affecting the situation in Holland also. In June of 1925 the Dutch cost of living was again somewhat above the American, and in 1925 unemployment did not fall to the same low level as in 1924, whilst the seasonal increase in the winter was somewhat above that of 1924-5, though not very much above. The figures seem to warrant the statement that by the time Holland returned to the gold standard its internal price-level had become fairly well adjusted to the world

HOLLAND
(From the League of Nations' Monthly Bulletin of Statistics)

Date	Gold Cost of Living	Cost of Living. 1911-18 = 100	Note Circulation		Bank Rate %	Unemployment Percentage of workers unemployed among Trade Unionists	Gulden in New York ¹ (Parity in 40.196 cts = 1 gulden)	American Cost of Living	Ratio of Costs of Living
			Bank Notes (Million gulden)	State Notes (Million gulden)					
1924									
January			1,008	32	5				
February			984	32	5	22.4	37.350		
March	165	179 ^a	1,018	31	5	17.3	37.416		
April ..			1,001	31	5	11.2	37.057	170	103
May ..			993	31	5	9.0	37.193		
June ..	161	173 ^a	983	29	5	8.2	37.406		
July ..			964	29	5	5.8	37.435	169	105
August			999	28	5	7.9	37.942		
September	168½	176½	972	27	5	8.7	38.804		
October			998	26	5	8.2	38.451	171	101
November			964	24	5	8.8	39.103		
December	182	181	935	23	5	11.1	40.051		
1925			922	22	4½	12.7	40.416	173	94
January			912	21	4	15.1	40.407 ^a		
February			898	20	4	12.2	40.170		
March ..	177½	179	866	19	4	9.4	39.921		
April ..			900	19	4	7.9	39.949		
May ..			900	19	4	7.9	40.185		
June ..	178½	179	889	18	4	6.6	40.135	174	97
July ..			900	18	4	8.3	40.102		
August			899	18	4	8.5	40.242		
September	179	179	879	18	4	7.7	40.208		
October			940	18	3½	7.1	40.200		
November			906	17	3½	9.1	40.227		
December	177	177	875	17	3½	10.0	40.187	178	100
1926			865	16	3½	17.7	40.181		
January			851	16	3½	10.5	40.080		
February			821	16	3½	7.9	40.067		
March ..	173	174	817	15	3½	6.5	40.126		
April ..			844	14	3½	6.3	40.198		
May ..			809	14	3½	8.3 ^a	40.1750		
June ..			846	14	3½		40.1732		
July ..									

price-level, so that the actual formal adoption of gold did not make much difference. How far wages have become adjusted is a different matter, but the fact that unemployment, in spite of the repercussion of depression in Germany, has not sensibly risen, is some evidence that real wages have not been rising.

(b) Poland

§ 36

The Polish currency was stabilised in the early part of 1924. By the end of the year exchange was already somewhat under par with the dollar, and by the end of 1925 had again lost almost 50% of its nominal gold value. Unemployment fell to a minimum in May, 1924, more than doubled in twelve months, and doubled again in the next twelve months. The exchange first gave way seriously in August, 1925. The gold cost of living reached a maximum of 144, and, under the influence of a falling exchange, has been decreasing ever since. Wholesale prices, in terms of gold, also rose during 1924 and the first half of 1925, to give way under the influence of a falling exchange. At no time did the cost of living or the wholesale index number touch world parity on the basis of the index numbers available. The explanation of the renewed Polish crisis must seemingly be sought elsewhere than in Polish prices rising above world prices. To begin with, the stabilisation of the Polish exchange

took place just at the moment when cost of living prices were rising faster than wholesale prices. At the beginning of 1923 gold wholesale prices stood at 77; cost of living prices at 58. By the end of 1923 gold wholesale prices stood at 95; the cost of living index at 80.¹ During 1923 the cost of living index rose from 75% of wholesale (gold) to 84% of wholesale (gold). In January, 1924, the ratio was 112: by June, 1924, cost of living prices were 24% above wholesale. In January, 1925, they were still 20% above wholesale: by the end of the year they were 10% above wholesale. To this extent the problem is one of disproportionate movements of different price series.

But the movement of relative prices is not the only factor to be taken into account. Consider next the economic situation. The normal effect of a period of inflation is to devour the real resources of the community. The effect of the stabilisation of the currency is to reveal the absence of real resources, and, by removing the exchange risk, to encourage foreign loans. On the economic side these loans are reflected in an excess of imports over exports. If the funds so lent are short-period credits, the foreign currency reserves of the Central Bank are liable to pressure if, for any reason, these credits are called. During 1924 the deficit of the harvest caused an importation of foodstuffs, and, therefore, the volume of

¹ These are the figures given in Zdzeschowski, *The Finances of Poland, 1924-5* (London, 1925), where it is pointed out that pre-war prices were based on the prices in Russian Poland. The rise in prices is, therefore, understated as compared with pre-war years (p. 9). The cost of living figures refer to Warsaw, and probably, therefore, exaggerate the rise.

credits abroad to be larger in amount. The danger to the Central Bank increased. The bad harvest directly affected employment in agriculture, and reacted on the position of industry. The industrial situation was in itself affected by the difficulties with Germany and the generally unsatisfactory position of the iron and steel industries. But the excess of imports continued to August, 1925, which shows that—apart from “invisible” items—additional foreign credits *must* have been obtained.¹

The rise of prices in 1924 was produced, not only by an increase in the volume of Central Bank currency, but also by a not inconsiderable issue of silver and paper token moneys by the State. By the end of 1924, when the circulation of the Bank of Poland amounted to 550 million zlotys, the net circulation of State tokens amounted to 123 million zlotys.² The issue of these moneys played a not inconsiderable part in the budgetary policy of the Polish Government, but, since the country clearly required a larger circulation than it did at the time when everyone was fleeing from the local currency, the source of issue is not important. What *is* important is that the amounts of such currency continued to increase *after* the Bank of Poland had begun to retire its notes. The decline in the Bank-note issue is itself associated with the beginning of the crisis in midsummer 1925, and that in turn with the illiquidity of the Commercial Banks. This led

¹ Emigrants' remittances play, of course, an important part in Poland's balance of payments, as they do in that of Italy.

² Zichschowski, *op. cit.*, p. 66.

to a retirement of deposits and a partial cessation of payments by the Banks,¹ this in turn provoking distrust, to sales of zlotys abroad, a cancellation of foreign credits : a movement which the Bank assisted by limiting its sales of foreign currency from July, 1925.²

The policy of credit restriction upon which the Bank relied thereafter may be sound or unsound : but it is certain that it is useless to carry on such a policy if it is accompanied by an expansion of the volume of Government money. This is recognised by the Bank itself : "In the actual conditions of the country deflation has not given results of consequence, in view of the diminution of the Bank's influence on the money market as a result of the much too large paper-money issues of the Government."³

It is an old rule that restriction of facilities during a crisis makes the crisis worse. But this rule is subject to an important unwritten premise — "provided that the exchanges are stabilised." The absence of credits from abroad is caused by the falling exchange : if the Bank of Poland attempts to take the place of such foreign assistance it is trying to make water run uphill so long as it has not succeeded in stabilising the exchange : for every increase in the circulation adds to distrust, and, consequently, to the flight from the currency. The fact is that in Poland the policy

¹ *Compte rendu des opérations de la Banque de Pologne pendant 1925*, p. 15.

² p. 18.

³ *Op. cit.*, p. 16. But why add (p. 14) : "This state of affairs made the maintenance of exchange difficult, but at the same time attenuated the evil consequences of the policy of deflation"?

Date	Living Jan. 1914 =100	Bank Notes		Token coins and notes	Bank rate %	ment	(Parity 19.30zts. = 1 zloty) Million marks per dollar	Polish Cost of Living	prices		
		Million Polish Marks	Million Zloty	Million Zloty		No. of unemployed			Zloty	Gold	
1924	January ..	120.5	313,659,830			9	110,530	9.3	121	107	107
	February ..	127.4	328,913,419			12	110,737	9.25			
	March ..	126.3	396,244,206			12	109,531	9.25			
	April ..	126.5	570,697,549			12	121,000	9.25			
	May ..	125.6	299,338,687	245		12	97,870	9.25			
	June ..	123.7	141,858,402	334		12	137,830	19.2928	124	101	101
	July ..	127.2	34,229,367	394		12	152,021	19.2465			
	August ..	134.7	18,182,665	430		12	159,820	19.2284			
	September ..	141.1	10,804,556	460		12	156,110	19.2188			
	October ..	150.6	5,785,000	504		12	144,860	19.2181			
	November ..	151.6	3,782,000	498		10	150,180	19.2074			
	December ..	153.1	3,314,000	551		10	161,940	19.2035			
1925	January ..	144.6	3,146,400	553		10	175,020	19.1788	144	120	119
	February ..	145.9	3,106,800	550	213	10	184,430	19.1800			
	March ..	147.0	3,078,000	563	218	10	185,400	19.1831			
	April ..	146.2	3,036,600	567	212	10	178,480	19.1780			
	May ..	143.0	2,770,200	557	225	10	173,140	19.1872			
	June ..	144.2		503	269	10	171,340	19.1858	143	119	118
	July ..	145.6		462	325	10	174,729	19.0815	144	120	118
	August ..	148.3		440	332	12	184,910	17.8527	137	124	119
	September ..	149.1		397	395	12	195,044	17.5888	136	127	116
	October ..	152.0		382	410	12	213,480	16.6558	131	128	110
	November ..	157.2		362	410	12	249,666	15.7400	128	137	112
	December ..	173.0		381	440	12	313,709	10.8435	97	155	87
1926	January ..	170.0		362	419	12	359,119	12.8664	113	142	100
	February ..	170.7		377	415	12	358,002	13.1536	118	146	100
	March ..	168.5		389	426	12	346,431	12.6888	111	146	92
	April ..	175.6		393	436	12	320,512	11.3292	108	167	98
	May ..	183.2		413	442	12	303,720	9.8836		181	93
	June ..	182.6		448	460	12		9.3015		175	84
	July ..	177.2		511	427	10		10.0654			

* Zloty prices since January, 1921.
† Based on the exchange rate against zloty notes

† 1,800,000 Polish marks=1 zloty.
‡ 20th July

of Bank and of Government have been at cross purposes in recent months, and the ultimate cause of the difficulty is probably a non-recognition of the fact that, though stabilisation may effect an immediate improvement in the situation, it cannot overcome the handicap imposed by a previous process of *entgüterung*—of the gutting of real resources provoked by inflation.

(c) *Germany*

§ 37

By the time the German currency was provisionally stabilised—in November, 1923—it was clear that the intoxicating effects of inflation had worn themselves out. The optimistic view, which was at one time fashionable, that an endless boom could be maintained by the simple expedient of endless inflation, received its death-blow as soon as it became obvious that the rate at which the value of a currency declines is more than proportionate to the increase in its quantity. The value of the German currency was exceedingly low¹: prices, though not at world level, were fluctuating directly with the dollar value of the currency: trade became more and more impossible as hoarding of goods replaced sales for cash. In any case, the creation of the rentenmark and the stabilisation of the paper mark in terms of

¹ "On November 15th, 1923, the total circulation of Germany had a value of 458.7 million gold marks."—*Report of the Commission of the Reichsbank*, June, 1926, p. 16. This figure works out at about 6 to 8 gold marks *per capita*, possessing a purchasing power, in terms of pre-war, of 4s. 6d.

the former did not immediately relieve the situation: throughout the first quarter of 1924 unemployment remained at a high level, though already with a falling tendency, whilst the volume of the " industrial credits " of the various Central Banks was showing a marked tendency to expansion. Between January and April, 1924, they in fact doubled. The monetary counterpart is to be seen in an expansion of the note circulation of the Reichsbank from 484 million reichsmarks to 690 millions, and an increase in the rentenmark circulation from 1,200 millions to 1,700 millions. But so long as the demand for currency *per capita* was expanding, the increase in the volume of circulation would not necessarily exercise any marked effect upon prices. In any case, the process by which the price-level would ultimately be raised was already at work. General prices, in fact, remained steady in the first quarter of 1924: Dr. Elsass's index of the cost of living and the Reichs index both show a slight fall.¹ Real wages showed a rise of five points in the first quarter—from 74 to 79.

In April, 1924, the first important event of the new era took place—the Reichsbank, alarmed by a weakening of the international quotation of the stabilised currency, began to ration credit on April 7th. It limited its volume of discounts to the amount outstanding on that date, although undertaking to redistribute amounts among the various classes of borrowers in accordance with

¹ Elsass index (January 1914 = 1): 1.98, 1.10, 1.10.
 Reichs index 1.47, 1.44, 1.47.

convenience.¹ It thus becomes necessary to ask, first, how German economic life has developed since that date, and to what extent monetary policy has acted as a restraining or lubricating factor.

The position, broadly speaking, is of continuous improvement from the beginning of the second quarter of 1924 to the end of the third quarter of 1925. The Konjunkturinstitut, indeed, finds in the events of 1924-5 an exemplification of a complete trade-cycle—depression from November, 1923, to June, 1924: revival from June to January, 1925: boom from February, 1925, to September: a crisis in the last quarter of that year, and depression from February, 1926, onwards. But this is, perhaps, too schematic to account for the detailed movements of particular indices, though it may give a correct enough impression of the general trend.

The index of especially sensitive commodities (*reagiblen Warenpreise*), comprising scrap, bar-iron, lead, zinc, hides, hemp, linen, yarn, rye, and wheat, prepared by the Konjunkturinstitut, shows that the maximum was reached in January, 1925, with an index of 164½ (1913 = 100). The prices of *industrial raw materials* reached a maximum of 152 as early as May, 1924, and have fallen almost uninterruptedly since, being only 131 at the end of 1925. The prices of industrial finished products reached a first maximum of 158.5 in May, 1925, fell to new minima of 143 in August and December, 1924, rose from thence to a fresh maximum of 154 in September, 1925, and fell

¹ *Verwaltungsbericht der Reichsbank für das Jahr 1924*, p. 4.

Date	Cost of Living Base, October, 1911, January, April, June, 1914	Note Circulation		Bank Rate %	Unemployment		Weekly wages in R.M. (Reich)		Industrial credits of the note-issuing banks Million R.M.	
		Million Reichsmark	Million Rentenmark		Wholly unemployed %	Partially unemployed %	Skilled	Unskilled		
1924	January ..	110°	(Mds) 483,674,521,358	1,196	10	26.5	23.4	28.45	23.18	1163
	February ..	104	587,874,526,821	1,564	10	25.1	17.1	28.61	22.86	1557
	March ..	107	689,864,440,190	1,760	10	16.6	9.9	29.19	22.33	2007
	April ..	112	776,948,637,505	1,769	10	10.4	5.8	31.66	23.55	2177
	May ..	115	926,873,543,864	1,729	10	8.6	8.2	33.90	25.36	2187
	June ..	112	1,007,308,572,182	1,772	10	10.4	19.4	35.44	26.29	2125
	July ..	115	1,211,038,485,128	1,803	10	12.5	28.2	35.71	26.41	2031
	August ..	114	1,391,895,246,161	1,832	10	12.4	27.5	35.90	26.56	2217
	September ..	125	1,520,510,653,712	1,853	10	10.5	17.5	35.95	26.57	2488
	October ..	122	1,781†	1,715	10	8.4	12.2	36.48	27.05	2736
	November ..	122.5	1,863	1,677	10	7.3	7.5	37.30	27.83	2884
	December ..	122.6	1,941	1,835	10	8.1	6.5	38.44	28.61	3044
1925	January ..	124.1	1,901	1,780	10	8.1	5.5	38.78	28.03	2923
	February ..	135.6	2,106	1,736	9	7.3	5.3	39.18	29.23	3043
	March ..	136.0	2,315	1,611	9	5.8	5.1	40.14	29.88	3015
	April ..	136.7	2,452	1,480	9	4.9	4.9	41.26	30.54	3116
	May ..	135.5	2,669	1,531	9	3.6	5	42.25	31.17	3185
	June ..	138.3	2,474	1,672	9	3.5	5.2	42.93	31.71	3260
	July ..	143.3	2,530	1,701	9	3.7	5.8	43.90	32.37	3301
	August ..	145.0	2,595	1,713	9	4.3	6.9	44.42	32.86	3277
	September ..	144.9	2,649	1,713	9	4.5	8.5	44.90	33.17	3295
	October ..	143.5	2,803	1,543	9	5.8	12.4	45.10	33.28	3234
	November ..	141.4	2,771	1,480	9	10.7	16.0	45.96	33.90	3044
	December ..	141.2	2,967	1,476	9	19.4	19.8	45.98	33.92	3186
1926	January ..	139.8	2,649	1,450	8	22.6	22.6	45.98	33.92	2775
	February ..	138.8	2,822	1,335	8	22.0	21.6	46.02	33.95	2553
	March ..	138.3	3,160	1,121	7	21.4	21.7	46.02	33.95	2464
	April ..	139.6	3,086	1,556	7	18.6	19.1	46.02	33.95	2186
	May ..	139.9	2,878	1,373	7	18.1	18.2	46.02	33.95	2066
	June ..	140.5	2,971	1,388	6½	18.1	17.2	45.93	33.92	2130
	July ..	142.4	3,107	1,501	6					

† From Vierteljahrshefte zur Konjunkturforschung, Heft I, 1926, p. 81; Heft II, 1926, p. 82.

continuously thereafter. Thus the first category of goods rose by nearly 37% in thirteen months, and then fell by 23% in eleven months: the second category first rose by 5% in five months, and then fell by 14% in nineteen months; while the third category first rose by 2% in five months: fell by 4.5% in seven months: then rose by 8% in nine months, and then fell again. The general index number of the *Frankfurter Zeitung* shows five wave movements: (1) a fall from January to 3rd July, 1924, from 142 to 130; (2) a rise from thence to February, 1925, from 130 to 147; (3) a slight fall to the end of May (141); (4) a rise to 143 in August, 1925, and then four months in which the index stands at 144 (roughly); (5) a period of falling prices, beginning at the end of January, 1926, and continuing, the figure for July being only 135. These movements partly agree with, partly contradict, the schematic representation of the trade-cycle set forth above.

§ 38

Unemployment fell continuously from January, 1924, to July, 1925. During this period three sub-periods are noticeable: the first, from January, 1924, to September, 1924, during which the trade union index of unemployment fell from 26.5% to 10.5%: a second period, ending in April, 1925, during which it fell from 8.4% to 4.3%: a third, June to August, 1925, when it was stable at 3.5%. From that time to February, 1926, it rose continuously, reaching a maximum

of 23% in February, 1926. Since that time it has fallen somewhat to 18% in July. The figures of the numbers receiving unemployment relief move closely with the trade union index of unemployment. Wage rates, both for skilled and unskilled workers, continued to rise throughout the whole period, and only began to show a slight fall in April, 1926: the cost of living reached a maximum (145: 1913-4=100) in August, 1925, on the basis of the Statistical Office Index, and 134 on the basis of the Elsass Index in September: real wages reached 99 (1913=100) in November and 104 in January, 1926. Thus, depression in Germany and in this country have succeeded in bringing real wages somewhat above the pre-war level. This development is in part an expression of world factors (i.e. the general tendency of world prices to fall): partly of the adjustment of German prices as a whole to the world-level, and partly of the adjustment of German prices to one another. Of the three series of industrial prices those of "finished products" have varied least, and during part of the period were falling whilst the prices of the "sensitive" commodities were still rising,¹ hence profit-margins must have been

¹ cf. *Report of the Agent-General for Reparation Payments, 1926, p. 46.*

² The relative position of each of the three categories of "Sensitive Commodities," "Industrial Raw Materials," and "Finished Products" was in each quarter:

	S.C.	I.R.M.	F.P.		S.C.	I.R.M.	F.P.
1924				1925			
1st Qr.	100	113	117	1st Qr.	100	89	93
2nd Qr.	100	117	121	2nd Qr.	100	90	105
3rd Qr.	110	111	114	3rd Qr.	100	98	111
4th Qr.	100	93	99	4th Qr.	100	103	118
				1926			
				1st Qr.	100	105	118

diminishing: wage costs must also have risen, except in so far as higher money wages were offset by greater efficiency. Further, whilst up to March, 1925, the level of wholesale prices was higher than the cost of living level, since that time the situation has been reversed: in March, 1925, the ratio of cost of living figures to wholesale was 93, by October, 1925, it was 100, and in June, 1926, it was 103. Both wholesale and cost of living indices have been falling, but the former less than the latter.

§ 39

The second question is, what part has monetary policy played in this development? The turn of the economic tide came, clearly enough, in the autumn of 1925, up to which time unemployment continued to fall. What had been the policy of the Central Banking authorities up to that time? Up to the end of 1924 the Reichsbank adhered to its policy of rationing, though it increased the quota by 10%, admitted three months bills and Bank acceptances to discount, made advances to the Prussian State Bank in order to assist the discount market for trade bills, lowered its discount rate for foreign bills, and reduced the discount rate at the Gold Discount Bank from 10% to 8%.¹ During 1925 the Bank rate was itself reduced to 9%, the discount rate of the Gold Discount Bank to 7% in May and

¹ *Verwaltungsbericht für das Jahr 1924*, p. 5.

to 6% in October, and the Reichsbank further agreed to discount the "acceptances of certain first-class banks and bankers without including them in the aggregate total which it had laid down for the granting of credit." Nevertheless, the "strict credit policy introduced in April, 1924, in the interests of the currency could not be given up before the month of December, 1925."¹

There was, then, some relaxation of credit control in the course of 1925. During 1924, even, there is noticeable a distinct growth in the volume of "industrial credits" *after* October: between April and July the figure is almost constant. In 1925 the volume rises from 2,923 millions in January to a maximum of 3,301 in July; after that there is a slow and then a fairly rapid decline. But these figures are not in themselves conclusive in any way: the Reichsbank might ration credits, but it does not follow that German industry was, therefore, deprived of assistance. The high rates of interest and of discount simply meant that alternative sources of supply, the international money markets, might be drawn upon. Foreign money lent to German industry and to German municipalities was just as efficacious in providing credit as the discount of bills at the Reichsbank, "for foreign credits, not directly used to pay for imports, can only be employed in Germany after conversion into reichsmarks. The purchase of foreign exchange, moreover, was in conformity with the currency policy of the Bank. If it had

¹ *Report of the Reichsbank for 1925* (English edition), pp. 2, 4, 8.

refused to accept large sums in foreign exchange there would have been danger of losing the stability of the currency, and of causing the over-valuation of the mark as compared with foreign currencies."¹ It is true that the Bank does not like short-term credits, and used its power to get attempts by municipalities to borrow abroad to be placed under official control²; nevertheless, without taking into account the volume of foreign borrowing, a proper picture of the German credit situation in recent years cannot be obtained. The very policy of dear money which prevented borrowing from the Reichsbank stimulated foreign lending: the policy of the Reichsbank is to be regarded as one which throws on to other centres the provision of funds—a policy which at one and the same time reduces the "fiduciary" volume of notes and increases the total of all notes, in so far as the notes are issued against foreign currency balances or bills sold to the Bank for German mark notes or balances.

There was, in fact, throughout the whole period of stabilisation, an uninterrupted increase in the volume of currency until the first quarter of this year. The figures of the various authorities (Reichsbank, Reichsbank Commissioner, Konjunkturinstitut) do not quite agree, but the general picture they give is in all cases the

¹ *Reichsbank Report for 1925*, p. 7.

² *Op. cit.*, p. 8; *Report of the Agent-General, June, 1926*, p. 27. The Agent-General estimates the volume of foreign loans during 1925 at 1,255 million reichsmarks. The *Reichsbank Report* states that "capital to the estimated value of 24 milliards of reichsmarks had poured into the country from abroad." This, presumably, includes short-period credits.

ame. By quarters the development has been as follows :

1924	1st Qr.	100
	2nd Qr.	114
	3rd Qr.	134
	4th Qr.	153
1925	1st Qr.	160
	2nd Qr.	171
	3rd Qr.	182
	4th Qr.	186
1926	1st Qr.	182

It is, of course, perfectly true, as Mr. Keynes has argued, that the "real interest" rate represented by a given nominal rate will rise if prices either do not go on rising, or even start falling. From this point of view, the fact that the Bank rate did not fall as rapidly as prices certainly exercised a deterrent influence, and to that extent the Reichsbank pursued the hateful policy of restricting credit. The real question is, however, whether, if the Reichsbank had *not* exercised pressure, say, in the second half of 1925, the expansionist tendencies in German industry would not have gained ground. Up to June, 1925, with unemployment falling (as measured by the trade union index) almost to vanishing point, the policy of the Reichsbank can hardly be severely criticised. After that time—and especially in November, and December, when unemployment was rising enormously—it may be argued that the Reichsbank ought at once to have reduced its rates. It did, in fact, reduce

them considerably in the first half of 1926, so that the rate is now (at 6%) only moderately above the British Bank rate, and considerably below the rate at the end of 1925. The question, then, resolves itself into one of asking whether Bank rate ought not to have come down two months earlier. Perhaps it ought; but it does not follow that unemployment would immediately have been relieved. The advocates of "leave it to the Central Bank to manage" have, unfortunately, not yet found the magic formula by which the managers of such Banks can rid themselves of all the difficulties of a managed currency, even when they are only trying to peg their currency to the dollar. An element of discretion *must* remain, and, so long as this is the case, it is easier to look back and see what ought to have been done than to look ahead and judge what it is best to do under the circumstances.

(4) THE SITUATION IN THE LATIN COUNTRIES

§ 40

In all these countries the general position is superficially much the same. In all of them the gold cost of living is still far below the world level: in all of them there have been plans, sometimes avowed, sometimes hidden and discernible only from the figures of the Central Bank, for the stabilisation of the local currency: in all of them unemployment is low, and industry, on the whole, prosperous: in all of them the

tendency is for gold accountancy and gold contracts to take the place of contracts in terms of the local unit: in all of them the currency has recently been showing signs of greater instability, and in all of them the true methods of reform are supplemented, partly for "psychological" reasons, and partly because of ignorance and prejudice, by a whole series of specious devices—financial dictatorships, control over speculation and the exchanges, the re-introduction of war-bread, Press campaigns against the foreigner and the speculators; in a word, the mobilisation of mob-instinct and nationalist sentiment.

There are, however, not unimportant differences. The first is that in France and in Belgium the Budget is unbalanced—or, rather, would have been unbalanced without the use of inflation (it is too early to speak of the ultimate effects of the new taxes in France¹ and the financial "dictatorship,"² coupled with the compulsory funding of the floating debt, in Belgium)—whereas in Italy the Budget not only balances, but the Government has been able to accumulate large balances at the Central Bank which, in the eyes of some observers of the situation, are the "crux of the present situation, which lies, not in the balance of payments, not in the Budget situation, but in the risk of an increase in note-issues consequent upon an unforeseen obligation causing the Treasury to withdraw deposits from the Bank

¹ *Economist*, 31st July, 1926, p. 207.

² *Economist*, 24th July, 1926. The Belgian State railways are to be leased to an autonomous company: out of a possible 10 milliards of preference shares 2 milliards are to be used for funding Treasury bills falling due mainly in December next (1,250 millions).

of Italy. The monetary problem, from a strictly monetary point of view, can be put thus: how to keep the total note-issue under the 20 billion level, even when the public deposits are reduced to their normal level of, let us say, 500 million lire."¹ But, as it is admitted by the *Economist* correspondent that the Government balances are in fact already being lent out by the Bank, it does not follow at all that a redistribution of these balances must affect in any way the total note-issues. However that may be, at the moment the Budgetary position seems sound enough, and cannot be used as an explanation of the falling value of the lira.

In terms of sterling, of course, these Latin currencies were bound to fall in value. It is however, sometimes overlooked that if gold prices are falling whilst franc and lira prices are rising, or, at any rate, not falling, these currencies are bound to fall in terms of dollars also. Since gold prices have been falling in the recent past, a fall in these paper currencies was to be expected. And, since a paper currency offers a greater field for the operations of the speculator than a metallic one, and any fall, for any reason, is liable to set up panic sales, even a small change in the gold value of a currency, due even to changes in the value of gold, may induce a still greater fall in the future. Whilst the *malaise* of French and Belgian finance is in itself a breeding-ground for disorganisation in currency, the Italian difficulties must be sought in other directions.

¹ *Economist*, 10th July, 1926.

From this point of view it is not altogether uninteresting to observe that it makes no difference whether notes are issued in response to "commercial demands" or in response to "Budgetary demands." In Italy there is no "Budgetary" demand for inflation: it does not follow that there is no inflation at all. But the total note-issue has been rising nevertheless, and a marked change is noticeable in this respect between the last six months of 1924 and those of 1925. The total note-issues (apart from the State notes which have remained unchanged throughout 1925) are divisible into three groups: those issued for "the State"; for "general purposes"; and for the "Sezione Autonoma del Consorzio Sovvenzione su valori industriali". The notes issued under the first and last heads have fallen off somewhat, but the notes issued for "general purposes" and the total issues have moved as follows (milliard lire):

	Bank-notes issued for General Purposes		Total Bank-notes	
	1924	1925	1924	1925
June	6.1	8.3	20.1	21.1
July	6.0	8.6	19.9	21.4
August	5.9	8.8	19.8	21.5
September	6.4	8.8	20.2	21.6
October	6.7	8.8	20.5	21.6
November	6.6	8.6	20.3	21.3
December	6.8	8.8	20.5	21.5

¹ These figures are taken from R. Bacchi's article in the *Wirtschaftsblat* of 16th April, 1924.

Thus there was a rise of about 5% in the note circulation in the last six months of 1925, in spite of a rise of the official Bank rate and the inauguration of a policy of the close co-operation between the great Banks and other lenders and the Ministry of Finance for the limitation of credit and discrimination in lending,¹ which was followed in March, 1926, by the formation of an inter-bank consortium with a capital of 100 million lire, for the support of securities and the placing of capital increases under official control.² The decline of the lira, of course, shows the complete futility of the repressive measures of control over the foreign exchanges adopted in August, 1925, which does not argue well for the further measures of monopolisation of exchange dealings adopted in May of this year.³

§ 41

The fact is that one ought to find the key to much that has been happening in Italy in 1925 and since in the period of stabilisation which obtained in previous years. For eighteen months—between the middle of 1923 and the end of 1924—the average gold value of the lira was stable, taking Mortara's figures as the basis of the argument, and, with the exception of the first six months of 1923, had remained stable for two

¹ Bacchi, *Wirtschaftsdienst*, 10th October, 1925. ² Bacchi, loc. cit., 23rd April, 1926.
³ v. *Wirtschaftsdienst*, 18th June, 1926. [This passage was written before the recent measures were announced, heralding a reduction in the note-circulation.]

years.¹ So long as the exchange remained stable the cost of living and prices generally could climb up towards world-level: during 1924, in fact, the gold cost of living did rise from 114 to 126. Internal conditions permitted an industrial boom, but any sign that this boom was coming to an end would at once react upon the position of the exchange, so long as definitive stabilisation was not adopted. What appears to be the case is that the evil day of adjustment has been put off by a fall of the exchange. It is nothing to the point that "exchange control" has been practised; this did *not* prevent the fall. If it had been effective the exchange would have been more stable, but the industrial situation would probably have been worse.

§ 42

In Belgium the policy of the banking authorities was to arrive at stability of credit conditions. The Bank, so it is stated in the report of 1925, followed "un politique restrictive de crédit ingrate et pénible, difficile à concilier avec son vif désir de favoriser l'industrie et l'exportation. Elle comprima le volume réel de son portefeuille commercial et de son portefeuille d'avances." In fact, the *gold value* of the bills discounted was

¹ Gold Value of Lira :

	1922	1923	1924	1925
1st half	26	25	23	21
2nd half	23	23	23	20

v. Mortara, "Prospettive Monetarie" in *Revisita Bancaria*, May, 1926.

² Report, National Bank of Belgium, 1926, p. 8.

ITALY
(Figures from the League of Nations' Monthly Bulletin of Statistics)

Date	Cost of Living (Jan.-June, 1914=100)	Note Circulation		Bank Rate %	Unemployment		Value of lira in New York (Parity 19.30 cts. = 1 Lira)	Gold Cost of Living
		Million Lire			Wholly Unemployed ¹ (000's)	Partially Unemployed (000's)		
		Bank Notes	State Notes					
1924 January ..	310	16,768	2,428	5	280.8	54.2	cents.	
February ..	317	16,559	2,428	5	259.4	19.3	4.3400	114
March ..	324	16,810	2,428	5	218.7	20.8	4.3452	
April ..	322	16,758	2,428	5	176.9	45.6	4.2769	
May ..	318	16,547	2,428	5	155.9	22.6	4.4408	
June ..	318	17,825	2,428	5	130.8	16.5	4.4396	
July ..	312	17,513	2,400	5	117.9	22.9	4.3328	116
August ..	311	17,353	2,400	5	119.0	21.4	4.3035	
September..	316	17,761	2,400	5	115.6	21.2	4.4446	
October ..	346	18,078	2,400	5	117.1	24.1	4.3820	
November ..	363	17,892	2,400	5	135.6	13.9	4.3804	
December ..	373	18,114	2,400	5	150.4	10.0	4.3335	
1925 January ..	380	17,646	2,400	5	156.4	10.1	4.3019	126
February ..	392	17,471	2,400	5	156.7	11.7	4.1669	
March ..	602	17,693	2,300	6	142.5	14.3	4.1082	
April ..	600	17,645	2,100	6	126.5	16.3	4.0719	
May ..	591	17,744	2,100	6	101.4	11.6	4.1030	
June ..	596	19,017	2,100	7	85.5	6.9	4.0672	
July ..	598	19,276	2,100	7	79.5	4.3	3.8273	118
August ..	610	19,431	2,100	7	72.2	5.8	3.6677	
September..	624	19,474	2,100	7	82.8	7.2	3.6573	
October ..	643	19,480	2,100	7	85.8	8.1	4.0640	
November ..	643	19,201	2,100	7	112.1	5.1	3.9915	
December ..	649	19,350	2,100	7	122.2	8.9	4.0048	
1926 January ..	665	18,651	2,100	7	156.1	9.3	4.0312	135
February ..	661	18,198	2,100	7	125.8	8.0	4.0376	
March ..	654	18,295	2,100	7	109.5	8.3	4.0264	
April ..	642	17,899	2,100	7	98.2	6.8	4.0156	136
May ..	652	17,724	2,100	7	98.5	8.6	4.0200	
June ..	650	17,581	2,100	7	83.3	6.7	3.8728	
							3.6646	123

314 millions in 1924 and 315 millions in 1925, the advances on securities 98 and 97 millions respectively. Retail prices at the end of 1924 and 1925 were 521 and 334 : the dollar rate of exchange in 1923, 1924, and 1925, 19.4, 21.8, 21.1 francs. The dollar loans raised in December, 1924, and June, 1925, were not required till the autumn of 1925, when the news that the Government had decided to stabilise caused a reversal of tone on the foreign exchange market and the Bank had to intervene. The stabilisation plan was duly presented to the Chambers : the Act was promulgated on 26th February, 1926. The plan comprised the raising by Government of one or several loans up to a total of 150,000,000 dollars : the abrogation of clauses in the Bank Act by which the Bank was relieved of the obligation of paying its notes in gold : the fixing of a new gold value for the Belgian franc : the revaluation of the gold reserves at the new stabilisation rate : and the turning over of the loans to the Bank, which was to use them and the proceeds of the revaluation of its gold reserve to cancel State indebtedness to the Bank up to a similar amount.

Everything was thus ready for a return to the gold standard. Unfortunately, difficulties raised by the financial groups approached during March, 1926, a panic consequent thereon, and, perhaps, some fear of the consequences of stabilisation to Belgian industry unless the French franc were simultaneously stabilised caused an abandonment of these efforts for the time being. On the

BELGIUM

(Figures from the League of Nations' Monthly Bulletin of Statistics)

Date	Cost of Living (1921=100)	Note Circulation (/000,000,000 Francs)	Bank Rate %	1 Value of Belgian Franc in New York (Parity, 8.1828 Fra. = 1 dollar)	Gold Cost of Living	Unemployment	
						Part time (% among Trade Unionists)	Whole time (% among Trade Unionists)
				Cents			
1924 January	127	7.59	5½	4.18	70	2.2	1.5
February	128	7.65	5½	3.84		1.9	1.6
March ..	130	7.68	5½	3.87		1.4	0.6
April ..	124	7.70	5½	5.23		2.0	1.0
May ..	119	7.62	5½	4.86	76	2.3	0.9
June ..	123	7.58	5½	4.56		2.3	1.0
July ..	125	7.76	5½	4.56		2.5	0.8
August ..	127	7.64	5½	5.02		2.4	0.7
September	128	7.63	5½	4.94		2.3	0.7
October	134	7.63	5½	4.80		2.0	0.9
November	137	7.60	5½	4.83		2.7	1.0
December	137	7.59	5½	4.97	92	3.6	1.5
1925 January..	139	7.65	5½	5.06		4.3	2.0
February	137	7.60	5½	5.08		4.6	1.7
March ..	136	7.55	5½	5.07		5.5	1.5
April ..	131	7.67	5½	5.02	83	5.5	1.6
May ..	128	7.49	5½	5.02		4.9	1.2
June ..	131	7.56	5½	4.70		4.8	1.1
July ..	133	7.69	5½	4.62		4.0	1.1
August ..	136	7.65	5½	4.33		2.9	0.9
September	139	7.76	5½	4.40		1.9	0.8
October	141	7.65	5½	4.53		1.8	0.7
November	141	7.62	5½	4.53		5.0	2.3
December	143	7.81	7	4.52	87	4.6	2.8
1926 January..	139	7.46	7	4.54		5.4	2.7
February	140	7.42	7	4.54	78	3.1	1.6
March ..	137	7.69	7½	4.23		2.8	1.4
April ..	140	7.92	7	3.67		2.0	1.3
May ..		8.35	7	3.12		2.1	1.0
June ..		8.51	7	2.96			
July ..		8.08	7	2.40			

contrary, Parliament authorised the National Bank in May to discount up to 1,500 millions of Treasury bills in order to meet the demands made for the repayment of six months' Treasury bills,¹ and, though in July Parliament delegated financial legislative power to the Crown for a period of six months, and a variety of other devices have been resorted to, the *Economist* correspondent reported on 24th July that "a speedy return to the gold standard appears, however, not yet to have been definitely decided upon, as the Finance Minister has lately expressed the opinion in Parliament that a return to the gold franc is not yet desirable, seeing that it would cause a tremendous increase in prices, and throw thousands out of employment."²

§ 43

The currency situation in France is almost completely dominated by the exigencies of finance. At the beginning of 1925 the authorised note circulation amounted to 41 milliards,³ the authorised limit of advances to the State to 22 milliards. By laws of 15th April, 30th June, 23rd November, and 4th December, 1925, the advances and the circulation were increased by successive steps of 4, 6, 1½, and 6 milliards to 39½ and 58½ milliards respectively. The advances

¹ *Economist*, p. 1069 (1926).

² *Economist*, 24th July, 1926, p. 166. To which is added, significantly: "It remains to be seen whether a speedy return to world prices, even at the cost of an industrial crisis (which will have to be faced sooner or later when stabilisation comes), would not be preferable to the slow process of impoverishment through which Belgium is going at present, owing to the discrepancy between the internal and the external purchasing power of the franc."

FRANCE

(Figures from the League of Nations' Monthly Bulletin of Statistics)

Date	Cost of Living (1914 = 100)	Note Circulation	Value of dollar in Paris (Parity, 5.1826 frs. = 1 dollar)	Bank Rate %	Unemployment	Value of franc in New York (Parity, 19.30cts. = 1 Fr.)	Gold Cost of Living
		Million Francs			Number in receipt of benefit		
1923 December..	345		francs			cents.	
1924 January ..		38,834	21.43	6	1,248	4.6650	
February ..		39,345	22.65	6	1,042	4.4191	
March ..	365	40,214	21.71	6	1,022	4.6812	88
April ..		40,021	16.36	6	750	6.1573	
May ..		39,556	17.34	6	805	5.7919	
June ..	366	40,115	19.04	6	547	5.2528	100
July ..		40,325	19.57	6	490	5.1185	
August ..		40,034	18.36	6	475	5.4635	
September ..	367	40,534	18.84	6	447	5.3016	101
October ..		40,529	19.10	6	403	5.2292	
November ..		40,447	18.95	6	451	5.2757	
December ..	377	40,885	18.51	7	509	5.3988	106
1925 January ..		40,516	18.54	7	705	5.3923	
February ..		40,792	18.93	7	1,029	5.2796	
March ..	386	40,904	19.20	7	1,016	5.1807	103
April ..		43,050	19.26	7	931	5.1877	
May ..		42,703	19.38	7	675	5.1632	
June ..	390	43,800	20.98	7	626	4.7666	96
July ..		44,496	21.30	6	637	4.6081	
August ..		45,445	21.32	6	581	4.6912	
September ..	401	46,354	21.22	6	618	4.7124	98
October ..		46,679	22.55	6	523	4.4312	
November ..		49,184	25.31	6	557	3.9622	
December ..	421	51,085	26.75	6	645	3.7358	82
1926 January ..		50,618	26.61	6	534	3.7708	
February ..		50,991	27.23	6	775	3.6782	
March ..	451	52,127	27.95	6	543	3.5804	84
April ..		52,208	29.52	6	432	3.3885	
May ..		52,735	31.91	6	386	3.1508	
June ..	485	53,914	34.12	6	489	2.9415	74
July ..		56,022		7½	354	2.4658	

were almost doubled, and the note-issues increased by 40% within twelve months. The process has since been continued: on 15th July, 1926, M. Caillaux called on the Bank of France for the residue of the Morgan credits of 1923, the grant of which had originally formed the basis of Poincaré's successful squeezing of the bears after the first great débâcle of the franc. This residue amounted to 33 million dollars. The Bank agreed to surrender these dollars only on condition that it was to be allowed to increase the note-issue by a corresponding amount. The Bill introduced in consequence became effective on 22nd July, 1926, raising the effective limit by a sum equal to the yield from the (franc) value of the dollars transferred.

The Poincaré Government has gone a step farther. In the guise of an Act to increase the metallic reserves of the Bank, it has in fact given the Bank power to disregard the limits imposed upon the issue of notes. The four-clause Act passed by the Chambers in July¹ allows the Bank to buy French gold coins at a premium; to buy gold in the open market and to increase its note issue for the two above purposes; whilst it is further permissible for the Government and the Bank to conclude "all the necessary arrangements to enable it to prepare the way for the stabilisation of the currency by the rehabilitation of the franc."

The idea that, so long as the franc is not

¹ *v. Economist*, 14th July, 1926, p. 394, and *Economic Review*, 18th August, 1926, p. 135.

convertible into gold or dollars or foreign exchange, an increase of the note-issues based upon gold is not inflation is fallacious. The gold value of the franc will depend, after as before, upon the aggregate quantity in relation to the demand for francs. The Bank of France is, in fact doing exactly what the Bank of England did before the Resumption Act of 1819: instead of cutting down its notes and, therefore, increasing the value of what remains, it hopes to keep up the value of an increased total of notes by increasing the metallic reserve. On the other hand, the fact that the Bank is allowed to buy gold at a premium is in itself an inducement to the devaluation of the franc, for if the franc rises above the buying price of the new gold the Bank necessarily makes a loss on the transaction.

The suggestions on which this Act is based are, as a matter of fact, taken from the Report of the Committee of Experts. Once the limit of the advances to the State is definitely fixed, argues the Report, the fixing of a definite limit to the circulation has no further justification, and, in fact, presents serious inconveniences for the commercial activity of the Bank, and may hamper it in the purchase of exchange and of gold which are necessary to strengthen its reserve.¹ And, in fact, so long as French prices are not adjusted to the world level, there is bound to be a further increase in the note-issue. But, until it is known that the Bank definitely intends to stabilise, an increase in the circulation will defeat its own

¹ *Rapport du Comité des Experts*, p. 46.

object. For the condition of a successful increase is that the population should be willing to accept it; and this willingness, as things are, is itself a function of the stability of the exchange. Hence, in the eyes of the Experts, the desirability of making the period of "pre-stabilisation" as short as possible.

§ 44

There is, in fact, on moot points no substantial difference between the policy, as so far stated, of M. Poincaré and that of the Experts. The Report does not wish to rely upon the gold resources of the Bank in the first instance¹: nor does the Premier. M. Poincaré desires the "rehabilitation" of the franc before it is definitely stabilised²: but the Experts also thought that "le choix d'un cours du franc plus favorable que le cours actuel serait désirable." The differences concern, then, the ratification of the debt agreements and the sources from which the stabilisation credits are to be obtained. The Committee believed that foreign credits could only be obtained after ratification, and wanted ratification because it desired the foreign credits. M. Poincaré's policy on these matters is still obscure. But it has a fighting chance of success, even if *no formal* foreign credits are raised, *provided* that the rate of interest is high enough to attract

¹ Op. cit., p. 44.

² Cited, *Economic Review*, 6th August, 1936: "Before stabilising the franc, we mean to rehabilitate it to the greatest extent possible. The restoration of the currency, the improvement of the franc, will be the first step towards stabilisation at which we must all aim."

foreign funds, if they prove to be needed, and confidence in the franc is raised by an early definitive scheme of stabilisation which will cause a reflow of money now hoarded in Dutch, Swiss, and British banks, for such a reflow would in itself provide the Bank with large reserves, which might be required when stabilisation brings on industrial depression, as it most certainly will.

From this point of view, the higher the stabilisation rate the better, provided that the rate is not so high as to overvalue the franc. For the way to prevent a depression is to avoid the preliminary boom. Some depression will no doubt be inevitable: for prices have been rising too long in France to prevent something in the way of a collapse when they no longer rise. But if the franc is given a low permanent gold value, the margin to be overcome between internal and external prices will be the greater, the up-rush of prices the greater, and the reaction the heavier. No doubt a low value of the franc seems at first sight to relieve the Treasury, for it is, of course, equivalent to partial repudiation of the funded and floating debt.¹ But recent experience throws considerable doubt upon the validity of the policy implied. For other current expenses

¹ *The Report of the Experts*, p. 131 et seq., states the debt of France, as at 31st March, 1936, as follows:

	Milliards
(1) Funded debt, internal ..	163.4
(2) Short term debt, internal ..	93.0
(3) Floating debt, internal ..	93.4
	<hr/>
	387.7

Foreign debt at par:

(4) Inter-Governmental	31.5	(Say, in present paper
(5) Commercial	5.1	francs, 250 milliards)

rise in proportion as the value of the currency has fallen, and, unfortunately, the holders of Government debt are not content to sit tight and be robbed of the greater part of their property, *permanently*. Nothing is more certain than that, to a greater degree in France—the country of the *rentier*—than elsewhere, any such policy would lead to a political campaign for the “*valorisation*” of the debt, which no Government would be able to resist without the certain prospect of defeat.