

THE ART OF CENTRAL BANKING

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THE ART OF CENTRAL BANKING

BY

R. G. HAWTREY

AUTHOR OF "CURRENCY AND CREDIT," "THE ECONOMIC PROBLEM"
"MONETARY RECONSTRUCTION," "THE GOLD STANDARD"
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PREFACE.

A VOLUME composed of a number of separate articles or essays may be compared with a federally constituted State, in contrast with a unitary volume, in which the chapters are as inseparably linked as the departments of a unitary State.

In the present work, one of the component essays has so outgrown the normal dimensions appropriate to a constituent of a federal volume that it has arrogated to itself the position of a Prussia.

Nevertheless, I have thought it best neither to segregate that essay in a separate volume nor to degrade the others from their autonomous position to that of chapters. I have retained the form of a collection of essays, all subject to the common sovereignty of a single theme, but each self-contained. Any one of them can be read independently of the others, and they can be taken in any order the reader may choose.

As the book is actually arranged, the subject is introduced by two essays describing recent events, one on *French Monetary Policy*, and the other on the Wall Street Speculation and the Crisis of 1929. These provide an approach by raising problems of central banking in practical form.

The third essay is entitled *Consumers' Income*

and Outlay. It explores in fuller detail a system of monetary analysis which I have already employed in other books, and which I have used extensively in the present volume. This detailed exposition is not essential to the understanding of what follows, for the meaning of the terms used has been indicated in more summary fashion where they are introduced. But it is offered to those readers who prefer a background of theoretical precision even for ideas which are intelligible without it.

The fourth essay is that which gives its name to the book. If the subject of central banking is classed as an art and not as a science, it is not for that reason any the less scientific. The art of central banking is practical in that it teaches how to use a power of influencing events. It is concerned, not merely with the relation of cause to effect, but with the relation of means to end.

But there is no less scope for systematic reasoning in the study of means than in the study of causes. The pursuit of wisdom is as scientific as the pursuit of truth.

Economic theory, in every branch, deals with practical affairs. Its subject is human welfare, and it is never entirely dissociated from the practical question of how human welfare is to be promoted. But it is a special characteristic of the art of central banking that it deals specifically with the task of an authority directly entrusted with the promotion of human welfare. Human welfare, human motives, human behaviour supply material so baffling and

elusive that many people are sceptical of the possibility of building a scientific edifice on so shifting a foundation. But however complex the material, and however imperfect the data, there is *always* an advantage to be gained from systematic thought. We may have to be satisfied with probabilities, but we can at any rate see to it that our probabilities make the most of the data we have.

Here what is commonly called theory, far from being academic, is simply the reading of past experience. The more intricate the subject, the more inadequate and indeed misleading is the empiricism which evolves practical precepts haphazard from the superficial uniformities of the past.

A central bank is entrusted with the regulation of credit, and under modern conditions the regulation of credit includes the regulation of money. Money is the nervous system of industry, and the due functioning of economic activity throughout its entire range is dependent upon the proper regulation of money.

I have started with a description of the evolution of the art of central banking through the practices of the Bank of England in the nineteenth century, and have then proceeded to a theoretical exposition of the art and so to an interpretation of recent events.

In the theoretical exposition, the fundamental principle is the power of the central bank, through its regulation of credit, to bring about what I have called a "release of cash" or an "absorption of cash," and thereby to enlarge or to compress the

consumers' income and outlay. It is through the exercise of that power that the central bank discharges its responsibility as the source of money.

One of the most important conclusions in regard to the art of central banking is that the power of a central bank ought to be used to prevent undue fluctuations in the price level, or, given an international gold standard, that the principal central banks ought to concert measures to stabilise the value of gold. The essay entitled *Money and Index-Numbers* is devoted to showing what meaning ought to be given to stability of the price level for the purposes of such measures. Like the essay on *Consumers' Income and Outlay*, it is in the nature of a technical digression, but it is essential to a complete treatment of our subject.

The sixth essay is a criticism of Mr. Keynes's *Treatise on Money*. Possibly those readers who have made a study of the *Treatise* may prefer to read the criticism before they turn to the essay on the *Art of Central Banking*. Otherwise they will be constantly wondering how the views expounded in the latter fit in with those of Mr. Keynes, how far they are incompatible, and how much common ground they have. Mr. Keynes emphasises the provisional character of the theories in his *Treatise*, and in what I have written I have kept this in mind, and I have endeavoured to make my criticisms constructive. I have also tried to give an adequate exposition of Mr. Keynes's own views on the matters dealt with, so that even those who are not acquainted with the *Treatise* may yet understand

the criticisms. But I ought to add for their enlightenment that they will find a great deal more in the *Treatise* besides the parts that I have dealt with.

The seventh essay is likewise concerned with Mr. Keynes's *Treatise*. It examines certain proposals which he made for modifying the technical practices of central banks.

The concluding essay shows how intimately the various remedies for unemployment, which come under discussion whenever business is depressed, are related to the characteristic instrument of central banking, the enlargement and compression of the consumers' income and outlay.

The last three essays were written for the Committee on Finance and Industry, presided over by Lord Macmillan. That on *Remedies for Unemployment* was printed with the Committee's Minutes of Evidence, and I have to thank the Controller of H.M. Stationery Office for consenting to its reproduction. It has not been materially altered, and it should therefore be read as applicable to the circumstances of the time, July, 1930, when it was written.

The essay on Mr. Keynes's *Treatise* has been considerably expanded, the passages on pp. 344-6; and 371-9 being practically all new, and taking the place of a much more summary treatment of some of the same topics. The rest of it, however, is practically unchanged.

The essay on *Money and Index-Numbers* was read to the Royal Statistical Society on the 17th

December, 1929, and was published in the Society's Journal. I have to thank the Council of the Society for agreeing to its being republished.

The essay on *French Monetary Policy* was read to the Manchester Statistical Society on the 14th January, 1931, and appeared in their Journal. It has been revised and brought up-to-date.

The essay 'on *Consumers' Income and Outlay* appeared in *The Manchester School* (Vol. II., No. 2), in October, 1931. It has been expanded by the insertion of some new passages, and by the addition of an algebraical note at the end.

The book contains my own personal views, and nothing in it is to be associated in any way with my official position in a Government Department. That applies to the three papers written for the Macmillan Committee as well as to the rest, for I was permitted to give evidence before that Committee in a purely personal capacity.

R. G. HAWTREY.

August, 1932.

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