

L.P. Study Courses No. 7

SOCIALISM
and
FINANCE

By
F. W. PETHICK LAWRENCE, M.P.

TEN OUTLINE LECTURES FOR
STUDY CIRCLES, WITH NOTES
AND BIBLIOGRAPHY FOR
CLASS LEADERS & STUDENTS



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SOCIALISM *and* FINANCE

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By

F. W. PETHICK LAWRENCE, M.P.

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HOW TO CONDUCT A STUDY CIRCLE

1. *Call a special meeting of the Branch to discuss the question of Socialist education. Invite all the people who are keen on working-class education, especially those who have some experience of tutorial classes and the like. Make it clear that your object is Socialist study, but that you welcome their advice and co-operation.*
2. *The class should be self-controlled. At its first meeting it should choose its own subject and its own tutor. It must have its separate Secretary and the person chosen should give as much time and attention to the class as a good Branch Secretary is expected to give to his Branch. Socialist study must be efficiently organised—casualness and anything-will-do-ism kills any class.*
3. *The class should choose as its tutor and leader one who has the experience and capacity to draw other people out. It will often find one just a little outside the ordinary Branch machinery. Many Socialists love this kind of work, but hate Branch routine. Find them out—draft them in—widen your circle of choice.*
4. *Co-operation must be the keynote of the class. It should be so conducted that the members and not the leader make the main contribution to success. Students should be encouraged to heckle the leader and to thrash things out to the bitter end.*
5. *The student must be encouraged to read and to write. The class meeting must be regarded as an introduction, and no student will be reckoned to have done his duty unless he or she follows up the subject during the week. At every meeting hints should be given as to books or parts of books to read before the next meeting. Essays on provocative subjects should be set and students stimulated to put their thoughts on paper. Both by voice and pen the art of self-expression should be insistently fostered.*
6. *Every student should be provided with a copy of the syllabus which the class leader should regard as the rough outline for his series of talks. It is not intended to be adhered to slavishly, but to be extended or modified according to the need of the moment or the wishes of the class.*
7. *Every class should make arrangements for providing itself with the necessary books. There are several methods of achieving this: (a) make the utmost possible use of the Free Libraries. In most districts the librarian will only be too glad to add to his shelves serious books for which there is an obvious demand; (b) use to the fullest extent the various institutions which provide book boxes (i.e., Fabian Society, W.E.A. Tutorial Class Library, Club and Institute Unions, etc.); (c) form Book Clubs through which the students, by subscribing a*

small sum each week, can obtain their own books. Every facility will be given in this direction by the I.L.P. Bookshop, Headland House, 308, Gray's Inn Road, London, W.C.

8. Keep a class register and do everything to encourage punctuality and regularity. See that the class does not degenerate into a mere desultory conversazione, but is a real educational effort. If at all possible charge a small fee for the term. People usually think more of what they pay for—even if it be only a nominal amount.
9. Make the class lively and interesting. Do everything possible to get within it variety of outlook. Stimulate discussion by inviting on occasions people who have a special contribution to make on the particular point under consideration.
10. If in any difficulty communicate with the I.L.P. Information Committee, 11, Adam Street, Strand, London, W.C.2, which is very anxious to help classes in every possible way.

The following syllabuses are now in stock :—

Economic History, by C. R. Attlee, M.A., M.P.

Foreign Policy and the People, by E. D. Morel, M.P., and H. B. Lees-Smith, M.A.

Socialism and the Mining Industry, by Emrys Hughes.

Socialism and Finance, by F. W. Pethick Lawrence, M.P.

Other syllabuses in hand are :—

Socialism for Women, by Minnie Pallister (ready end of February).

Socialism and Railways, by F. E. Lawley (ready shortly).

Socialism and the Land Worker, by Ernest Selley (ready shortly).

etc., etc.

SOCIALISM AND FINANCE

By F. W. PETHICK LAWRENCE, M.P.

INTRODUCTION.

MAN is a complex being. He has many needs and many activities—spiritual, moral, social, emotional, intellectual and material. All these are closely interrelated. Nevertheless, to a certain extent his material needs and activities can be considered apart from the rest. Such a consideration constitutes the study of Economics. Economics deals therefore with the production and consumption of material wealth, and also with its possession, distribution and exchange.

Finance is the algebra of economics. Every financial transaction is an economic transaction expressed for convenience in symbols. Money, credit, bank rate, cheques, bills of exchange, rates of exchange—the whole jargon of finance—are the “*x*,” “*y*,” “*z*” by which complicated economic facts are compressed into single symbols so that sums of addition, subtraction, multiplication and division can be worked out in them.

Thus suppose a man's house is burnt down and he is said to have “lost thereby £1,000.” We do not mean by this that he has mislaid 1,000 gold sovereigns, or that 1,000 £1 notes have been burnt up in the fire, but that part of his house and furniture and other articles have been destroyed by fire and that the exchange value of the destroyed things was £1,000.

Again, British exports for the year 1922 are said to have amounted to £720 millions. This does not mean that gold sovereigns or paper notes to this amount were sent out of the country; but that *things*—coal, iron, steel, machinery, cotton yarn and piece goods, woollen and linen articles, boots and shoes, etc.—were exported, and that all of these expressed in terms of money and added together, amounted to £720 millions.

STUDY ONE.

The Functions of Money.

MAN requires money to fulfil four distinct functions. Firstly, he wants a medium of exchange in order to get rid of the clumsy method of barter. Secondly, he wants a measure of value in order to express the exchange values of things in a single numerical equivalent. Thirdly, he wants to be able to carry about with him in small bulk, enough of his wealth to effect considerable purchases. Finally, he wants a measure of value which will remain the same to-day, to-morrow and a hundred years hence.

A MEDIUM OF EXCHANGE.

Money is the thing in which buying and selling is actually carried on. Thus: a workman works for an employer and wants in return food and shelter and the amenities of life for himself and his family. But he does not sell his labour direct for these things. His wages are paid to him in paper “Bradburys” and silver shillings. He and his wife take these to the shops and give them in exchange for the things they need.

A MEASURE OF VALUE.

Money is the thing in terms of which exchange value is expressed. We do not say "a pair of boots are exchangeable for ten pounds of tea, or for four-fifths of a pair of trousers." We say "the price of a pair of boots is 20/-, of a lb. of tea is 2/-, of a pair of trousers 25/-." Money converts complicated economic transactions into a page of entries in a book, and sums up the indebtedness of one party to another by a single numerical figure.

A STORE OF VALUE.

Money is the thing which people carry about with them when they want to effect purchases. Inside a small pocket book in this country a man may carry enough purchasing power to enable him to stock his larder for a week, or even to fill his whole house with furniture. On the Continent during the last few years money has often failed to fulfil this function. A very large and heavy bundle of notes were sometimes required by the housewife in Germany, Austria or Russia to buy the week's marketing; in fact, rumour has it that the Viennese women at one time had to use wheelbarrows to carry their money to the shops!

A STANDARD OF VALUE.

Just as we have the yard-stick and the lb. weight, so we need a permanent standard of value. If I set up a man in a shop to-day with stock-in-trade, I expect from him the same value when he comes to repay me a year hence, or whenever it may be. If the stock-in-trade is bought for £1,000 to-day, then he is said to owe me £1,000, and the repayment of £1,000 (plus interest) discharges his debt. This is on the tacit understanding that the £ is a true standard of value, and that its purchasing power on repayment is the same as that on the day when the loan was made. During the last few years in no country of the world would this agreement have brought about the equitable intention, so that nowhere has money fulfilled completely its function, as a true standard of value; while in Central and Eastern Europe the mark, the krone, and rouble have fallen so enormously that repayment of a loan in money bears no relation at all to its original purchasing power.

These functions of money are all distinct and are not necessarily performed by the same thing. Thus before the war gold was the measure of value, and the values of all other things were expressed in terms of how much gold they would exchange for, but the media of exchange for small purchases were silver shillings and copper pennies, and for large ones, bank notes and cheques. Again to-day (September, 1923) in Germany the medium of exchange is the million-mark note, but the measure of value is, sometimes a lb. of butter, or a ton of rye. Finally, wages in England to-day are paid in paper and silver, but in some cases the standard of value on which they are based is not a fixed number of shillings but is defined as the "cost of living."

Discussion Points for Students.

1. Are (a) bank balances, (b) cheques to be considered as money?
2. Build up a state of society in which all the functions of money are performed by different things.

Books to consult for the above study.

W. STANLEY JEVONS. "Money" (Paul, Trench, Trubner and Co. 7/6 net).

STUDY TWO.

Methods of Conducting Business.

IN our complex modern civilisation trade and industry are being conducted simultaneously in many different ways. These vary from the simplest one-man business conducted on a cash basis, up to the most complicated joint stock syndicate with all sorts of shares and debentures, with large overdrafts at its bankers and ramifications in many countries, and in many different trades—in a word, from the street hawker to the Standard Oil Trust. At the same time we have public ownership illustrated by municipal tramways and the national postal service.

ONE-MAN OWNERSHIP.

First in the order of simplicity comes the case of the business owned by a single proprietor. To begin with he buys raw material for cash, he pays cash wages to his workpeople, he sells his finished product for cash to his customers. His whole wealth consists of his plant and stock and cash in hand. Next he buys and sells on credit instead of for cash. He then has "liabilities" for the bills he has not yet paid, and his "assets" include not only his cash and plant and stock, but also the "book debts" owed him by his customers who have bought from him on credit. A further complication occurs when, in order to increase his working capital he mortgages his premises or secures an over-draft from his banker. In such a case the "mortgagee" or the banker must be included among his creditors in reckoning his liabilities. They differ, however, from the other creditors in having a mortgage deed or some other "security" which gives them a "prior" claim on the man's assets.

Suppose now his business comes to grief. All his available wealth, whether in the business or not, must be at the disposal of his creditors. First, the "secured" creditors take all that is necessary to satisfy their claims, and only after they are satisfied to the full, do the unsecured creditors come in. If the man's wealth is insufficient he is declared a bankrupt and the creditors only get so many shillings in the £.

PARTNERS.

The legal position of a business owned by men in partnership is precisely similar to that owned by a single person, except for their mutual relationship. Their rights as against one another are determined by the "deed of partnership," but to the outside world they stand as one man. Jointly they buy or sell for cash or credit, or borrow on mortgage or secure a bank overdraft. If their business comes to grief, the private wealth of everyone of them must be used to satisfy the creditors, and if all of it is insufficient they may all be made bankrupt. Thus a sleeping partner who goes altogether to sleep may have a very rude awakening!

LIMITED LIABILITY COMPANIES.

Originally a company was nothing more than a large partnership, of which some shareholders were sleeping partners and the others, called "directors" managed the business. But this sometimes worked great hardship. For if the business failed, shareholders with only a small stake in it might be called upon to pay large sums.

An illustration will make this clear. Let us suppose a company with a capital of 100,000 £1 shares of which 100 were held by A, and the rest in larger amounts by other persons—B, C, D, etc. The company came to grief; all the original capital of £100,000 had been used up and in addition its liabilities exceeded its assets by £50,000. The shareholders were all liable to "make good" out of their private means. Each shareholder received a notice of a "call" to pay 10/- for every £1 he originally subscribed. A received his call for £50 (i.e. on his £100) which he promptly paid. If every shareholder had also paid up, that would have ended the matter, but some of them had not much money and went bankrupt; others ran away. Only £20,000 was, in fact, subscribed, and the remaining £30,000 had to be found by A, E, F and H. Again A paid his "call," E went bankrupt and paid only £1,000, F and H bolted. Finally, A had to pay the remainder, making his total loss £29,050 in addition to the £100 he originally subscribed.

To meet this, a law was passed to the effect that a company of at least seven persons could have "limited" liability. If then the company comes to grief, the shareholders know the maximum they can be called upon to pay; and generally to-day the shares are "fully paid-up" in the first instance, and no more can be claimed from the shareholders at all. This sounds very hard on the creditors, but they have some corresponding protection from the laws about limited companies, and further, if they give credit to a "limited" company, they do so with their eyes open.

SHARES AND DEBENTURES.

Originally there was only one kind of shareholder in a company, and each share carried the same profit and ran the same risk of loss. But this has given place to-day to great variety. The reason is that some people prefer to have a safe investment, and others are more speculative and are willing to take a bigger risk if there is a chance of making a bigger profit. It frequently happens that a company is floated with ordinary shares, preference shares, and debentures. The debenture holders are not really shareholders at all; they are persons who lend money to the company at a fixed rate of interest (say 5 per cent.) and their loan is "secured" on some tangible asset of the company, perhaps its premises and machinery. Any profit there may be after paying the interest on the debentures, goes first of all to the preference shareholders up to a fixed percentage, say 7 per cent. The remaining profit generally belongs entirely to the ordinary shareholders who may thus get nothing, or 5 per cent., or 10 per cent., or 50 per cent., or whatever it may be.

If the company is wound up, the debenture holders come in first, then the creditors, then the preference shareholders, and finally if there is anything left the ordinary shareholders. But there are many complications and variations which leave room for individual choice,

and incidentally for exploitation of the public at the hands of unscrupulous persons

PUBLIC ENTERPRISE.

From a large company or syndicate to a municipal or national enterprise implies little change in the method of management. The Board of Directors is replaced by a sub-committee of the Council or by a Minister of State; taxes or rates receive the benefit of profits, and bear the burden of losses. The salaried manager is no longer the servant of the company, but is paid by the community and is expected to run the concern in the public interest.

Discussion Points for Students.

1. A business with a capital of £100,000 £1 ordinary shares makes a net profit of £2,000 in bad years and £15,000 in good years. What will be the effect on the ordinary shareholders of the creation of £50,000 6 per cent. preference shares, making total net profit run from £3,000 in bad years to £20,000 in good years?
2. Should public enterprise be run at a profit, a loss, or just so as to make ends meet?

Book Recommended.

HARTLEY WITHERS. "The Business of Finance." (John Murray 6/- net).

STUDY THREE.

The Title Deeds of Wealth.

PEOPLE measure their wealth in terms of money, but very little of it really consists of actual coins or notes. It is in reality "things"—dwelling houses and furniture; factories, plant, and machinery; engines, wagons, and motor cars; food, clothing, and raw materials; land undeveloped, and developed for the uses of men.

Small quantities of these things are not usually represented by title deeds; actual possession is enough. Thus a man keeps his watch in his pocket, his clothes on his back, his furniture in his house, his food in his larder. But the bigger or more distant things, or shares in things, are usually represented by "title deeds," which are the formal certificate of ownership.

"REAL" ESTATE.

By British law a man is allowed to own "freehold" property in land which is sometimes spoken of as "real" estate. His title deeds consist of the legal documents known as the "Conveyance," by which the previous freeholder "conveyed" the land to him, and the similar "conveyances" from previous owners.

LEASEHOLD ESTATE.

Land rented for a term of years, and houses built on that land are the subject of leaseholds, and the "lease" is the document giving a man the right to occupy the land and house subject to the payment of the annual rent.

MORTGAGES.

An owner of land or a house, and sometimes of other things, can (as it were) pawn them to another for a loan on which he has to pay interest. The owner remains in occupation but hands over as a title

deed a "mortgage" deed to the other, who is called the "mortgagee." If the interest is not paid regularly the mortgagee can "foreclose" and enter into possession (just as a pawnbroker under similar circumstances can sell the article pawned).

SHARES AND DEBENTURES.

Much of the actual wealth of the country is owned by companies, but they in turn are owned by shareholders. Thus a great railway company owns great tracts of country, massive stations, bridges, embankments, engines, carriages, freight cars, etc. Railway debenture holders hold a lien or sort of mortgage on this wealth, and the shareholders hold the remainder between them. Their title deeds are pieces of paper on which the value of their holding is registered.

PUBLIC BONDS AND STOCK.

Municipalities own wealth in the shape of gas or electric works, tramways, etc., and in order to start these they borrow money. To the lenders they give municipal stock, the security for which is partly the public enterprise but mainly the rates of the borough. The State also borrows money for war and other purposes. The lenders receive bonds or stock. The security for these is the wealth of the country as a whole, which can only be tapped through taxation. The title deed to most of these is usually not a piece of paper, but an entry in the books of the Bank of England.

BILLS, ETC.

Private persons, companies, and the Treasury, also give to people for goods delivered or for cash down, "Bills," which are in effect cheques with the date of payment postponed. These and other financial instruments must also be included among the title deeds of wealth.

TRUSTEE SECURITIES.

Among the above title deeds are some of a highly speculative nature, yielding varying rates of interest, others of a very secure kind, yielding a fixed rate. The latter are sometimes called "gilt-edged," and in view of the fact that trustees are by law empowered to invest in them, are also known as "trustee securities."

Discussion Points for Students.

Students are invited to institute a comparison between a mortgagee of a piece of land and a freehold landlord who has let his land to a tenant.

STUDY FOUR.

Banks.

THE primary function of a bank is to serve as a safe storehouse for money. It takes the place of the "old stocking" of the thrifty woman or the "hole in the floor" of the old miser.

Its next function is to provide means of paying money at a distance. Originally when the Paris trader bought silk from the Lyons silk manufacturer, he sent him gold coins which went in a special *diligence* from Paris to Lyons guarded by armed men. Meanwhile the Lyons folk were buying goods from Paris and sending gold from Lyons to Paris in another armed *diligence*. These *diligences* used to meet on the way. Then two families of Jews, one in Paris and one in Lyons, hit on the happy expedient of doing all the business without sending

any money at all. One acted as banker in Paris and one in Lyons. The Paris trader paid money to the Paris banker, who instructed his Lyons colleague to pay it out to the Lyons manufacturer, and vice-versa. The two bankers kept their accounts with one another in books, and from time to time, if necessary, sent the *balance* in gold. The bankers were able to charge as their profit nearly all that the merchants would otherwise have had to pay both for transit and risk. This profit they secured through their "confidence" in one another. Thus, from the first, banking depended not only upon the possession of wealth, but also upon the moral qualities of reliability and honesty.

BANK NOTES.

When a man deposited his money at the bank, he sometimes took from the bank a written promise to pay it back to him on demand. These promises, or bank notes, as they are now called, could be used, he found, to hand over to other people just as if they were money itself.

At first the banks did not issue more notes than they had money in their coffers to meet; but they gradually found that the actual money was never all demanded at the same time, so they traded with some of this money and left some of their notes "uncovered." Generally this was all right, but sometimes the banks carried this too far, and thus when there was a "run on the bank" the bank couldn't lay its hands on enough ready money and came to grief. After a specially big collapse of this kind a law was passed—the Bank Act of 1844—which limited the English issue of bank notes mainly to the Bank of England. This privately-owned institution gained these special rights in return for lending money to the Government; and it is now permitted to issue as many notes as it likes, but all except about £20 millions of these must be "covered" by gold in its vaults. The bank must always pay gold if requested in exchange for its notes, but the anticipation was that there would never be less than £20 million notes more in circulation than would be presented for payment in gold at any one time

CHEQUES.

The limitation imposed by the English law on the issue of bank notes drove the banks to extend another and, in some ways, a better expedient. They declared themselves willing to obey the written instructions of persons depositing money with them as to the disposal of that money. Thus A having deposited money at his bank B, and wishing to pay £50 to C, writes an instruction to his bank telling them to take £50 out of the money he has deposited with them and hand it to C. This written instruction (now called a cheque) he sends to C, who either proceeds with it direct to bank B, or passes the cheque through other intermediaries, who ultimately bring it to B. A's cheque is, of course, only good when two conditions are satisfied—firstly, the bank B must be solvent; secondly, the drawer A must really have a deposit at the bank B large enough to cover it.

For the second time the banks found that the whole of the deposits in their hands was never all required simultaneously, and that they could therefore trade with some of it, and still preserve enough to meet the requirements of their depositors. The form which their trading took was generally to lend it out to some of their own

depositors who wanted an "overdraft" to extend their business. This brings us to the question of "credit," which forms the subject of the next study.

Discussion Points for Students.

Students are invited to consider the case of a bank which has a run on its resources to the extent of £1,000,000 in a week, when at the beginning of the week its assets include £10,000 in coin and notes in its vaults, £240,000 deposited at the Bank of England, £250,000 consols, £250,000 invested in American railways, £250,000 lent in mortgages, £500,000 lent to its own customers who have pledged collateral security.

Students are also invited to consider the change in the proportion of gold in the vaults of the Bank of England to notes in circulation when out of £50 million circulating notes (covered by £30 million of gold in the vaults) £10 million notes are presented for payment in gold.

STUDY FIVE.

Credit.

PRIMITIVE man lives mainly from hand to mouth; but civilised society lays by a store of raw material for future use and of other things—shelter, clothing, food, etc., which will suffice to keep its population for a year or more, while they are devoting themselves to making future requirements. This store belongs to certain individuals who are prepared to sell it to the highest bidder. Anyone with a deposit at a bank can buy some of it. The banks with their power of employing the surplus deposits of their customers could buy some of it. What they actually do is to hand over the means of buying it to certain persons by giving them "credit." These persons having purchased part of the store with their credit, employ it to shelter, feed and clothe labourers while they are converting the raw material to such articles as they choose to have made. Thus in effect the banks, through their power of giving or withholding credit, have become the arbiters of the productive output of the community.

The actual form in which a bank gives credit is not to pay out money but to place a sum to the credit of its customer in its books. This sum is then reckoned as if it had been deposited by him, so that the bank, by giving credit, automatically increases the amount of its total deposits as shown in its books, without increasing at the same time the real money which it has in its vaults. Consequently there is a danger that one day there may be a "run on the bank" for money which the bank will not be able to meet.

Before the war this was a real danger. To counteract it the banks kept a reserve of money at the Bank of England, but this only thrust the responsibility one stage further back, as the Bank of England itself lent out of the money of its depositors. The Bank of England met the difficulty by a policy of giving easy credit when its reserves of gold were plentiful, and of making credit difficult when its reserves were short.

THE BANK RATE.

The instrument with which it operated is known as the "Bank Rate." This is the rate of interest at which the bank discounts bills. Anyone who gets credit from his bank has to pay this rate of interest

on the loan and a little more, depending on the bank's view of his reliability. Anyone who puts money "on deposit" at his bank is paid this rate less an amount (generally 2 per cent.). From time to time the directors of the bank vary the bank rate. Thus recently they put it up from 3 per cent. to 4 per cent. This meant that a borrower of fair reliability has to pay (say) 5 per cent. instead of 4 per cent. for the credit accorded to him, and he was less likely to want it on these terms; at the same time depositors got 2 per cent. (i.e., 4 per cent. less 2 per cent.) instead of 1 per cent. (i.e., 3 per cent. less 2 per cent.) on their money, and were more likely to entrust it to the banks. For both reasons, therefore, a rise in the bank rate increases the reserves of money at the bank. Lowering the bank rate similarly depletes the reserves.

A PAPER CURRENCY.

At the outbreak of war the danger of a "run on the banks" materialised, and to stave off disaster the Government came to the help of the banks and allowed them to hand out to their customers paper Treasury notes, known as Bradburys, instead of gold sovereigns. These Treasury notes were from the first made "legal tender," that is, people were compelled to accept them in discharge of a debt, and they could not demand to have gold instead. In this respect, therefore, they differ fundamentally from the old bank notes for which a person could always get gold if he liked. The difference is described by saying that whereas the old bank notes were "convertible" (i.e., into gold), the new Treasury notes are "inconvertible" and constitute an "inconvertible paper currency."

One result of the change is that the gold in a sovereign is to-day worth more than a paper pound, and prices in Britain are therefore higher than in those countries such as U.S.A., Sweden, and Holland, where a currency based on gold still prevails. Another result is that the reserve of gold at the Bank of England is not as necessary as it was, for Treasury notes can always be manufactured by the printing press if required. How far it is desirable to do so will be considered in a later study.

Discussion Points for Students.

Students are invited to consider what really happens in terms of economics when a bank uses the deposits of its London depositors to give a credit of £100,000 to (a) a London builder; (b) a Lancashire cotton spinner.

Books recommended.

R. G. HAWTREY. "Currency and Credit." (Longmans, 15/-)

STUDY SIX.

Foreign Trade.

ALL foreign trade consists essentially of the exchange of goods for goods. Many people deny this, but that is simply because their vision is not wide enough to take in the whole transaction. In old days the barter was done direct by merchant adventurers; in modern days the exchange is cloaked under financial symbols, and involves the mediation of financial houses.

Suppose an English miller purchases from an American farmer 100 tons of wheat at so many dollars a ton. The English miller,

who has a balance of pounds in his bank in London, has somehow or other to get dollars into the bank of the American farmer in Chicago. The banks receive their instructions in the form of pieces of paper called Bills of Exchange (which are something like cheques). But how are the bankers actually to do it? If the transaction stood alone they would certainly find a difficulty. But in reality it is one of a great number of transactions, in some of which Englishmen are buyers and want to send dollars to America, and in others Americans are buyers (say, of English cloth), and want to send pounds to England. Through the medium of the financial houses and of the paper Bills of Exchange, these transactions cancel one another out. The dollars stay in America, the pounds in England. The American farmers are paid with the dollars of the American cloth buyers, the English cloth sellers are paid with the pounds derived from the English millers. The economics of the transaction are a barter of cloth for wheat; but this has been converted into an affair of pounds and dollars. And just as in direct barter the "higgling of the market" would determine the actual amount of cloth paid for a ton of wheat, so under present methods the "higgling of the market" determines the rate of exchange between pounds and dollars.

RATES OF EXCHANGE WITH GOLD CURRENCIES.

If in both of two countries the currency rests on a gold basis, then the rate of exchange between them will never vary very much from the proportion of gold in their basic coins, for any tendency to do so is at once checked by the shipment of gold. Thus before the war the English pound was by law a little more than a quarter of an ounce of gold, and the American dollar a little more than one-twentieth of an ounce, so that the "par" exchange was at the rate of £1 for about \$5 (actually for \$4.86 $\frac{2}{3}$). If the exchange had fallen, say, to \$4.60 to the £ any Englishman could have made a big profit by taking pounds to his bank, getting gold for them, sending that gold to America, and there turning it into dollars and exchanging those dollars for pounds. This shipment of gold carried out on a large scale would raise the general level of prices in America and lower the level in England and restore the exchange rates to normal.

THE EXCHANGE TO-DAY.

This remedy is not available to-day because very few countries have a gold basis. In England people cannot to-day get gold from the banks by presenting Treasury notes and asking for it. That is why the American exchange is to-day (October 1st, 1923) below \$4.60. It is not available for Russia or Germany or France, for all these countries have inconvertible paper currencies, and the rates of exchange of roubles or marks or francs have no relation to the pre-war gold parity of those coins, but depends on the higgling of the market between sellers of Russian, German, or French wares and the purchasers in these countries of foreign goods. This higgling is accentuated by financial speculators who try to anticipate the future often with very poor success.

CAN THE EXCHANGES BE STABILISED?

Fluctuations in foreign exchanges are very bad for trade, for merchants contracting to buy abroad never know what they are committing themselves to until the bill is actually paid and converted into

their own currency. Yet, except for a general return of trading countries to a gold basis for their currencies (which to-day is very unlikely), there is no means of stabilising the exchange except through international action for stabilising prices.

Discussion Points for Students.

Students are invited to consider the following problems:—

1. *The difference in the effect upon British trade and employment between placing an order for £100,000 of steel rails in Belgium or in London.*
2. *Who were the people who were really affected when the exchange between the mark and the £ rose from 20 millions to 50 millions.*

Book recommended.

HARTLEY WITHERS. "The Meaning of Money." (Smith, Elder and Co. 6/- net).

STUDY SEVEN.

Prices.

DURING the forty years that preceded the war the average person did not trouble his head much about the general level of prices. To him a pound was a pound, a shilling a shilling, a penny a penny; for during all this time these coins bought roughly the same amount of things. Thus there was the penny post, the penny and the half-penny newspaper, the penny glass of beer, the penny-a-mile railway fare, the fourpenny and sixpenny dosshouse, and so on.

Under these circumstances when the docker got his famous "tanner an hour" in place of fivepence, when the bricklayer got 1/- instead of 11d., when the clerk got £3 a week instead of £2 10s., they reckoned on having more things for themselves and their families, and in the main they were right.

This idea of the stability of money has been rudely shattered during the last few years all over the world. Even in this country the pound at one time purchased little more than 5/- would have done before the war, and to-day little more than 10/- pre-war; so that now people ask not only "How much money shall I get?" but "How much shall I be able to buy with this money?" Of course, the price of everything has not gone up equally; some things have risen more than others. Rent has risen 40 per cent., steel 40 per cent., butter 60 per cent., bread 60 per cent., tea 100 per cent., bacon 100 per cent., beer 250 per cent., sugar 250 per cent. The manufacturer in comparing pre-war and post-war prices is thinking of machinery, wholesale materials, the housewife of her rent and the retail prices of her week's marketing. In both cases in order to gauge the change in the general level of prices it is necessary to take an average according to certain rules; in the former case it is an average of wholesale prices of commodities and is called an "index number," in the latter the average is popularly known as "the cost of living."

Changes in the general level of prices alter the effect of a contract between debtor and creditor to the disadvantage of one or the other of the parties. When prices rise the creditor is cheated, as in Germany when a farmer pays off a mortgage of 100,000 marks,

originally representing the whole stock of a large farm, by the sale of a single egg! When prices fall the debtor is cheated because he has to sell more goods to meet his bill.

But a still more serious result of price changes is the effect that they may have on business and trade generally, and consequently upon employment. To understand this, consider the case of a manufacturer laying out his plans for the future. He reckons that by using a certain quantity of raw material, which he can get to-day for £900, and employing labour, which will cost him a further £900, he can turn out a quantity of finished products whose selling price to-day would be £2,000. This provides him apparently with a profit of £200 to cover his overhead charges. But his finished product will take time to make; it will not be on the market to-day but perhaps six months hence. Suppose the price level changes during this time, what then? If prices have gone up 10 per cent. his product will sell for £2,200 and his profit will be £400 instead of £200—just double. If prices have fallen 10 per cent. in the six months his product will only sell for £1,800 and his profit will be nil, and all his overhead charges will be sheer loss. Thus in a period of falling prices manufacturers are very loath to manufacture. But this is not all; when prices are rising, dealers will order for stock because the unsold things will become more valuable (in terms of money) by keeping, but in times of falling prices they will live from hand to mouth because unsold goods will be all the time depreciating.

We are thus in a position to understand why it is that cycles of good and bad trade always correspond with cycles of price variation, why booms and good employment are associated with rising prices, and slumps and unemployment with falling prices. If, further, it be found possible by extraneous means to keep the general level of prices stable, this would go a long way towards preventing these cycles of good and bad trade and keeping employment steady and regular. The question of how far this stability of prices is actually possible will be considered later in the next study.

Discussion Points for Students.

What would be the effect on (a) manufacturers; (b) workpeople; (c) the prevailing rate of interest, of a currency whose value in terms of commodities was steadily falling, say, at the rate of 5 per cent. a year? (That is when the general level of prices was steadily rising at the rate of 5 per cent. a year.)

Books recommended.

F. W. PETHICK LAWRENCE, M.P. "Why Prices Rise and Fall." (Oxford University Press, 2/6).

F. W. PETHICK LAWRENCE, M.P. "Unemployment." (Oxford University Press, 2/6).

STUDY EIGHT.

Can Prices be Stabilised?

THE most obvious way of trying to fix prices is to do so by Act of Parliament. It sounds simple to decree that a pound of potatoes shall always sell for a penny, neither more nor less, and to threaten with dire punishment both buyer and seller when this law is broken. But it is generally forgotten that even if the law be rigidly adhered

to (and I fear it would often be evaded) the desired end is not necessarily accomplished. For what is wanted is not merely that every pound of potatoes which is actually sold shall be bought for a penny, but also that every person who wants a pound of potatoes shall be able to get it at this price, and that every farmer who has a pound of potatoes to sell shall be able to get a penny for it. The present method of competitive trading depending on supply and demand has many glaring defects; but it does succeed in general in disposing of the whole produce and in satisfying every person who is prepared to pay the necessary price. Mere price fixing by Act of Parliament would result in queues when the price was below the supply-and-demand price, and in gluts of unsold goods when it was above it.

During the war this truth gradually became realised, and to meet the difficulty elaborate rationing was resorted to, together with a certain compulsion on farmers and other producers. To a certain extent this was successful, but it involves a detailed interference with the lives of individuals which I do not think any free people would tolerate in time of peace.

However, even though we abandon the idea of fixing absolutely the price of every article, it may still be possible considerably to modify the fluctuations in prices in certain articles by wise direction of production and regulation of the reserves of stock. But more important than this is the possibility of absolutely fixing by financial means not individual prices, but the general level of prices. If this were done individual businesses might suffer periods of depression, but at the same time other businesses would be prospering, so that there would not result the cumulative general slump in trade with its concomitant of severe unemployment which is such a disastrous occurrence to-day.

Before the war, as has been pointed out already in Study Six, nearly every country had a gold basis for its currency. Accordingly the price of an article was a statement of how much gold it would exchange for, the amount of gold not being expressed in lbs. or ozs. but in terms of a coin of a certain weight. Thus in England as the sovereign was by law just over $\frac{1}{4}$ oz., the statement that a pair of boots cost £1 meant that a pair of boots exchanged for a little more than $\frac{1}{4}$ oz. of gold, or four pairs of boots for a little more than 1 oz.; and this was true more or less all over the world.

If, then, the British Government had suddenly decided to alter the amount of gold in a sovereign, say, to about one-eighth oz., four pairs of boots would still have exchanged for about 1 oz. of gold, but this would now have been called £8, and the price of boots expressed in money would have been doubled. Instead of a violent change of this kind it would have been possible by a slight alteration in the weight of the sovereign to make a slight alteration in the price level of a pair of boots and at the same time of all articles. Of course, in pre-war Britain this would have meant recoining all the sovereigns when the change was made, but in America, where they used paper dollars (though the paper had a gold basis), and in post-war Britain, where, though using paper notes as currency, we may still put them on a gold basis,* it would present no difficulty. Such a plan has actually been proposed by an American professor—Irving Fisher—

*By giving anyone the right to buy or sell gold at a definite weight for £1.

who proposes to use it to keep prices stable. When prices showed a tendency to rise he would lower them by increasing the gold in the sovereign and the dollar, and when prices showed a tendency to fall he would raise them by reducing the gold in these coins. There is much to be said for this proposal, but it has not the importance that it had because to-day so many countries have a paper currency quite unrelated to gold.

Another suggestion is being put forward to-day by a number of eminent men, including Cassel, the famous Swedish economist; Hawtrey, one of the prominent Treasury officials, and J. M. Keynes, famous for his treatises on German reparations.

It was noted in Study Five that the amount of credit given by the banks depended on the rate of interest charged by the Bank of England, commonly known as the bank rate. It is further generally known that the use of plentiful credit tends to put up prices. It is therefore suggested that alterations in the bank rate should be made in future with the deliberate purpose of keeping prices stable. When prices are rising the bank rate should be put up; as a result the money and credit in circulation will be reduced and prices will cease to go up. If, on the other hand, prices are falling, it is suggested the bank rate should be lowered, thereby encouraging credit and allowing prices to remain steady. This is a new policy and would not have been possible in old days when the Bank of England had to keep a reserve of money (gold) in its vaults to avoid catastrophe. Now that the currency is Treasury notes, which have no direct connection with gold and could always be printed if desirable, it would be possible, and there is good reason to think that it would be efficacious.

Discussion Points for Students.

Students are invited to discuss various possible ways of attempting to stabilise industrial prices.

Books recommended.

E. M. H. LLOYD. "Stabilisation." (George Allen & Unwin, Ltd., 4/6.)

R. F. HAWTREY. "Currency and Credit." (Longmans, 15/-)

C. E. PELL. "The Riddle of Unemployment." (7/6).

STUDY NINE.

Public Ownership of Banks.

In this country at the present time all the principal banks, including even the Bank of England, are owned by limited companies. The only banking institutions which are publicly owned are the Post Office Savings Bank and the Municipal Bank of Birmingham; neither of these fulfils all the functions of a bank, and the latter is confined to a locality. The Co-operative Wholesale Bank, though it is not owned by a company, cannot be cited as an example of full public ownership.

The consequences of this position are many. (1) The banks are not run in the sole interests of the community, but are concerned to make profits for their shareholders. (2) Their credit is given or withheld solely on financial grounds and not at all on account of the

value to the public of the work to be done. (3) The banks, by their amalgamations, have come within measurable distance of a "money trust." (4) Essentially public functions performed by the Bank of England, including alterations in the bank rate, which has been shown may be of supreme importance to the whole nation, are carried out without the control of and often even without any consultation with the Treasury. (5) At the same time the solvency of the banks is so essential to national well-being that the Government is absolutely obliged to put the whole national credit behind them if an emergency arises as it did in 1914. Finally (6) the profits of mutual finance are not available for the community as a whole, but become the property of the limited number of persons who have bank shares.

The practice of other countries does not conform to this English model. In America, though the Federal Reserve Banks are private institutions, they are controlled in part by a Board appointed by the Government. This Board exercises the function of regulating the American bank rate. In Australia there is not only a central Commonwealth bank, but this bank has branches in different parts of the country which compete for business with the capitalist banks.

The story of the Municipal Bank of Birmingham is interesting. Founded during the war strictly as a savings bank, it acquired wider powers from Parliament in 1919, and since that date it has gone rapidly ahead performing services for the people of the city, including the tradespeople, which the other banks do not provide, and enabling many of its depositors to obtain loans with which to acquire their houses. It is still, however, limited in many ways. For one thing, deposits of a single depositor cannot exceed £500, for another, there is no mechanism corresponding to the cheque by which the business of the ordinary banks is so largely carried on.

The Post Office Savings Bank, though available to everyone throughout the country, is, as its name implies, essentially in the nature of a money box rather than of a bank, as the word is understood to-day. It does not allow deposits in excess of £500 in one year. It does not use cheques. It will not advance money to its depositors, and the rate of interest which it pays on deposits is only $2\frac{1}{2}$ per cent.

Another kind of banking institution which prevails in other countries but which is absent in England is the Agricultural Bank. This has flourished in particular in Ireland. The principle is that a number of farmers get together and pool their mutual credit. When a loan is wanted by one of them the guarantee is provided by his neighbours, who, from their intimate knowledge of the man, are better able to judge his reliability than an ordinary bank manager. Where this plan has been adopted its benefits have been found to extend beyond the mere banking operations with which it started into the realms of co-operative buying and marketing which are of essential service both to the farmer and to the community.

Discussion Points for Students.

Students are invited to discuss what should be the limitation if any imposed on municipal banks.

Book recommended for the above study.

THOMAS JOHNSTON, M.P. "Municipal Banks." (I.L.P. 2d.)

STUDY TEN.

Constructive Proposals

THE general aim of Socialists is the use of the resources of the country as a whole for the communal good. Finance, being bound up with the whole economic machine, must be dealt with from the first. To begin with, the Socialist will aim at working through the existing financial institutions rather than by superseding them. There is good ground for believing that this will be quite possible and, if so, it will be the best method of approach. If, however, a Socialist Government were to be confronted with anything in the nature of deliberate sabotage of its proposals on political grounds by a Money Trust, it would have to be prepared for resolute action.

The primary object of money is to facilitate the operations of commerce and to create a steady flow of production. The private interests which have controlled money in the past have failed to secure these results, and have instead allowed to come about fluctuations in prices, with booms and slumps in trade and periods of terrible unemployment. Several leading economists and bankers now consider that this chaotic state of affairs could be prevented by manipulation of the bank rate with the requisite issue and withdrawal of Treasury notes. Assuming this view to be substantiated on further examination, Socialists will take the necessary steps to carry it out and thereby bring about stabilisation of the general level of prices and a steady flow of trade. This will be supplemented by action directed to reduce the fluctuations in individual prices.

The position of the Bank of England to-day as an uncontrolled arbiter of the whole of English business is an anachronism. One of the early actions of a Socialist Government will therefore be to secure that all decisions of the Bank of England which are of vital national concern, notably alterations in the bank rate, shall be subject to consultation with, and control by, the Treasury. The Treasury will, further, resume certain functions hitherto delegated to the bank. Ultimately the whole question as to the precise status of the bank, which is necessarily a national institution, will have to pass under the consideration of the Government.

Stable foreign exchanges are of paramount importance in the restoration of foreign trade. Stability cannot however be obtained by any one country alone. First the reparations question must be got out of the way, and then there must be common action on the part of all the countries concerned as to prices. Such common action might take the form of a universal return to the gold standard, but this is both unlikely, and in the opinion of many of our best thinkers, undesirable. Instead, the policy of stabilising prices if adopted everywhere, would achieve the required result. A Socialist Government will therefore aim first at stabilising prices in our own country as suggested above, and then at summoning a world conference to try to induce other countries to adopt a similar course.

Socialists will remove many of the limitations attaching to the Post Office Savings Bank. They will encourage the formation of municipal banks under proper safeguards. They will welcome the formation of agricultural banks.

With regard to the other parts of the banking system, including all the joint stock banks known as the "big five," Socialists will have to consider what they most wish to obtain. The first essential requisite is security for the depositor. This has not existed under capitalist governments which have allowed such institutions as the National Penny Bank and Farrow's to fail and ruin many small depositors, while they have buttressed up the bigger banks when in difficulties as in 1914. A Socialist Government will not allow any bank in which the public have invested, to fail.

The second essential requisite is what may be called the canalisation of credit, i.e. some selection of the channels into which bankers' credit shall be allowed to flow. It is not right that all enterprises, good, bad, and indifferent, from the communal point of view should receive equal treatment, at the hands of the banks. On the other hand, so long as private enterprise remains, freedom must be allowed to it to obtain credit on reasonable conditions.

It would be theoretically possible to obtain both these ends by immediate nationalisation of the whole banking system of the country. But such action would be fraught with very many difficulties and is by no means a necessary part of the early activities of a Socialist Government.

What I recommend is that the joint stock banks should remain for the present as they are, but that in return for the guarantee against failure suggested above they should be subject to a measure of public control. This would be exercised through the control by the Treasury of the policy of the Bank of England. The Government would lend its credit to the banks when necessary and might claim in consequence a share in profits. But the principal object of Government control would be to insist on preferential credit being given by the banks to works of public utility, while leaving ordinary enterprises to obtain such credit as the banks were prepared to give them in the ordinary way.

Apart from such changes in banking, the finances of any national enterprise, such for instance as the railway system, which may be converted from private to public ownership, will be run on the methods at present employed in national and municipal undertakings, the object being to give the best service possible for the public rather than to make a profit.

Finance is not a subject which admits of any finality. So long as things live they change. The evolution of a new social order under a Socialist Government will necessitate the evolution of a financial order to supply its needs. I do not consider it possible to anticipate the ultimate form which this financial order will take when the Socialist system is fully established.

What I have attempted is to indicate the direction in which Socialist finance must proceed and the first steps which can and must be taken by a Socialist Government.