



COMMITTEE ON FINANCE & INDUSTRY

REPORT OF COMMITTEE ON FINANCE AND INDUSTRY.
CMD. 3897.

CORRIGENDUM.

Page 308.

Table I, Introductory Note. Line 3. *After* 'occupations' *add* "covered by the Unemployment Insurance Acts."

Table I, right-hand column. *Delete* 'Workers for Export as a percentage of the whole occupied population' and *substitute* "Workers for Export as a percentage of the total numbers employed covered by the Unemployment Insurance Acts."

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REPORT OF THE COMMITTEE ON FINANCE AND INDUSTRY.

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COMMITTEE ON FINANCE AND INDUSTRY.

MINUTE OF APPOINTMENT.

Treasury Minute dated 5th November, 1929.

The Chancellor of the Exchequer states to the Board that he proposes to appoint a Committee to inquire into banking, finance and credit, paying regard to the factors both internal and international which govern their operation, and to make recommendations calculated to enable these agencies to promote the development of trade and commerce and the employment of labour.

The Chancellor further proposes that the Committee should be constituted as follows :—

THE RT. HON. H. P. MACMILLAN, K.C.,* *Chairman.*

SIR THOMAS ALLEN.

MR. ERNEST BEVIN.

THE RT. HON. LORD BRADBURY, G.C.B.

THE HON. R. H. BRAND, C.M.G.

PROFESSOR T. E. GREGORY, D.Sc.

MR. J. M. KEYNES, C.B.

MR. LENNOX B. LEE.

MR. CECIL LUBBOCK.

THE RT. HON. REGINALD MCKENNA.

MR. J. T. WALTON NEWBOLD.

SIR WALTER RAINE

MR. J. FRATER TAYLOR.

MR. A. A. G. TULLOCH,

with MR. G. ISMAY of the Treasury as Secretary.

The Chancellor proposes that the services of MR. F. W. LEITH-ROSS, C.B., † Deputy-Controller of Finance in the Treasury, should be made available at all times to the Committee in order to afford it such assistance as it may desire.

My Lords concur.

* Now Lord Macmillan.

† Now Sir Frederick Leith-Ross, K.C.M.G., C.B.

Report of the Committee on Finance and Industry.

TO THE LORDS COMMISSIONERS OF HIS MAJESTY'S TREASURY.

MY LORDS,

1. We, the undersigned Members of the Committee appointed by Treasury Minute of 5th November, 1929—

“ to inquire into banking, finance and credit, paying regard to the factors both internal and international which govern their operation, and to make recommendations calculated to enable these agencies to promote the development of trade and commerce and the employment of labour,”

have now the honour to submit our Report.

2. We held a preliminary meeting on 21st November, 1929, at which our terms of reference and the general lines on which our inquiry should proceed were discussed. Thereafter we at once began the hearing of oral evidence for which purpose we held 49 meetings. In all we examined 57 witnesses, several of whom attended on more than one occasion. The evidence which we have received was in many cases representative of the corporate opinion of economic organisations and industrial bodies, but we have also had the advantage of hearing the personal views of numerous witnesses specially qualified to deal with the more technical aspects of the problems before us. A list of the witnesses examined will be found at the end of our Report and will be seen to include a wide and varied range of representatives of banking and finance, both in this country and in the United States and Germany, as well as of industry and commerce from the point of view both of employers and of employed, while members of the Universities and the Civil Service and eminent economists of diverse schools have also lent their assistance. We have, in addition, received many written communications from individuals and from institutions and bodies interested in the various aspects of our inquiry. A list of these contributions is also given at the end of our Report. Apart from the meetings at which evidence was taken, we have met on many occasions for the purpose of hearing and discussing the views which certain of our members possessing expert qualifications desired to place before us. We also appointed Sub-Committees to deal with the preparation of statistics and the drafting of our Report, which held a number of meetings and by their labours materially lightened our task. We should add that, through the good offices of the Bank of England, the Bankers' Clearing House and others, we have had placed at our disposal a large amount of statistical material hitherto unpublished and inaccessible.

To all those who have thus assisted us we desire to express our great indebtedness.

3. To our Secretary, Mr. George Ismay, we find it difficult to express adequately our sense of obligation. He has done much more than discharge with zeal the ordinary, if arduous, duties which fall to the lot of a secretary of a Departmental Committee; he has also placed ungrudgingly at our disposal the remarkable and detailed knowledge which he possesses of our highly technical subject and has thus rendered us assistance of quite exceptional value.

PART I.—HISTORICAL AND DESCRIPTIVE.

CHAPTER I.—INTRODUCTORY.

SOME GENERAL OBSERVATIONS.

4. In addressing ourselves to the subject matter of our inquiry we desire to make a few general observations by way of preface. It would be difficult to conceive a more far-reaching investigation than that upon which we have been asked to embark, for the problems of finance underlie the whole field of human activities. Merely to deal in the abstract with the technique of the existing financial system, domestic and international, without relating it to the actual economic circumstances of the moment, would serve little purpose. If our inquiry is to render any public service we have to concern ourselves, as indeed our terms of reference exhort us to do, with practical matters. But this at once leads us into highly controversial regions. No doubt the duty of the members of such a Committee as ours is to approach their task entirely dispassionately, but when the problems confronting them are found to be intimately related to the political and economic topics of the day, on which convictions and pre-possessions, in some cases already publicly expressed, are ardently entertained, the roles of judge and advocate are apt to become confused and the difficulty of reaching conclusions acceptable to all becomes manifest.

5. Another difficulty besetting our task has been due to the complexity, not to say mystery, in which the problems of finance are involved. Every citizen is dimly aware that in some way his daily business is affected by the operations of the monetary system but he is quite unable to appreciate how it is so affected. It is no exaggeration to say that to the vast majority even of intelligent people the principles of finance and the theory of money are a closed book. When we turn to the experts for enlightenment we find that they fall into two classes. On the one hand we have those who are engaged in the practical business of banking and finance and daily operate the elaborate system of adjustments of which

the financial mechanism is composed. On the other hand we have the theoretical economists who as observers and critics endeavour to expound the rationale of that system. Between these two classes of experts—the practical financiers and the theoretical political economists—a certain antagonism is inevitable. The theorist seeks to rationalise the processes which he observes and to construct a scientific edifice of principles. The practical man finds in his office that he has to deal with a world ruled not by principles but by compromises and is impatient of the formulas of the study which he generally fails to comprehend. Indeed the epithets "academic," "theoretical," "doctrinaire," commonly applied to the philosophic thinker, have acquired a derogatory innuendo in the parlance of a nation which prides itself on its practical common sense and has an innate distrust of intellectual cleverness. The truth, as usual, lies midway. It is as foolish to disregard the analyses and generalisations of the scientific observer as it would be to believe that the world of finance could be successfully conducted by university professors. Each class has its contribution to make and it has been our endeavour to extract from the contributions of both such guidance as we could.

6. In view of the generally uninstructed state of the public on matters of finance we have from the outset recognised that not the least important service we might render would be to act as interpreters of the working of the monetary system and to make its main principles intelligible to the ordinary mind. Indeed, if our recommendations are to commend themselves to the public to whom they are addressed, they must be preceded by an intelligent appreciation of the problems to be solved. But this is an aspiration which we have not found it easy to realise. The subject is peculiarly intractable to handle from the popular point of view. The economic experts have evolved a highly technical vocabulary of their own and in their zeal for precision are distrustful, if not derisive, of any attempts to popularise their science. Moreover, agreement among the professors of the science is, as we have experienced, even harder to find than it generally is among experts and in their anxiety to avoid controversy they tend to avoid committing themselves to any definite conclusions. The difficulty of exposition really arises from the inherent nature of the subject matter. Political economy, like law, is not an exact science. It is concerned with a realm in which the incalculable elements of human psychology play a large part and the interplay of forces is extraordinarily complicated, and where, therefore, the exhaustive ascertainment of cause and effect is unattainable. But, as will be seen in the sequel, we have not been deterred from attempting to describe in some detail the nature of our financial mechanism and the method of its working, not indeed seeking to expound its more intricate refinements but confining ourselves to a general account of the system.

7. A period of economic depression such as that which the nation is now experiencing is a testing time for all our institutions, political, social and economic. Systems which in periods of prosperity have worked satisfactorily enough may at such times be found incapable of sustaining the stresses and strains of adversity and may disclose defects hitherto unsuspected. Machinery designed to work within a given range may jam when that range is exceeded. Moreover, there is a natural tendency on the part of the public to seek a scapegoat for any distress which may befall it and preferably to attribute that distress to any cause rather than its own shortcomings. In the search for a cause which should absolve itself from blame the public in the present instance has not been indisposed to find it in our financial system, none the less readily that refutations of the accusation are little likely to be appreciated. Accusation is always easy; defence even though well founded is often difficult. And what is least understood is apt to be most suspected. It has been our main task to examine the available evidence in order to ascertain to what extent, if any, the attribution of the present distress to monetary causes is justifiable, and then, so far as possible, to suggest remedies for any defects in the system we may have discovered.

8. If there is one characteristic of our times more conspicuous than another it is the recent growth among us of a spirit of self-consciousness. In the development of every civilisation there comes a stage when reflection awakens. While a nation is in the making it is so preoccupied with the practical business of gaining its livelihood and establishing its position that it has no time to bethink itself. Of our own nation pre-eminently it may be said that it has attained its great position not by the pursuit of any preconceived plan, but by a process of almost haphazard evolution based on trial and error and aided by the practical aptitudes and instincts of our race, as well as by certain fortunate accidents in the way of natural resources and geographical position. There has been little conscious direction of the national activities to definite ends. The policy compendiously known as "laissez faire" has prevailed. To this trust in the operation of natural causes we owe the development of our great political, financial and social institutions and the amazing growth of our industrial activities. But we also owe to it in part many of our deficiencies, such as our industrial instability, our social maladjustments, our slums. The most distinctive indication of the change of outlook of the government of this country in recent times has been its growing preoccupation, irrespective of party, with the management of the life of the people. A study of the Statute Book will show how profoundly the conception of the function of government has altered. Parliament finds itself increasingly engaged in legislation which has for its conscious aim the regulation of the day-to-day affairs of the community and now intervenes in matters

formerly thought to be entirely outside its scope. This new orientation has its dangers as well as its merits. Between liberty and government there is an age-long conflict. It is of vital importance that the new policy, while truly promoting liberty by securing better conditions of life for the people of this country, should not, in its zeal for interference, deprive them of their initiative and independence which are the nation's most valuable assets.

9. The lesson of all this for our present purpose is that in the case of our financial, as in the case of our political and social, institutions we may well have reached the stage when an era of conscious and deliberate management must succeed the era of undirected natural evolution. There are, as we shall see, already signs that the necessity for such a change of outlook is coming to be realised. The foundations of our financial system are being re-examined. Dogmas hitherto regarded as canonical are being questioned. The feeling is growing that our former easy-going ways will no longer ensure our prosperity in a crowded and increasingly competitive world. We are, indeed, at the parting of the ways and our future depends on whether we choose the right way. Hence the need for a careful study of the economic map. We must now choose our path deliberately and consciously. In other words we stand in need as never before of a definite national policy in our financial dispositions.

10. But the same admonition applies here as in the case of our political and social management. Financial policy must not be so imposed as to thwart the energies of enterprise. It should rather be so devised as to assist and give the freest play to those qualities which have won for us the premier financial position in the world. We have to deal with a system of peculiar delicacy. In no department of our affairs is caution more necessary, for the consequences of a false step may be incalculable. But the need for courage is no less than the need for caution.

11. An important thing to bear in mind is that financial policy can only be carried into effect by those whose business it is. We have in this country a great financial and banking organisation with great experience and great traditions. It is through and with that organisation that we have to work, for they alone are the repositories of the skill and knowledge and they alone possess the equipment necessary for the management of our financial affairs. Their views and opinions, however they may fail to commend themselves to enthusiastic reformers, are factors to be reckoned with just as much as the views and opinions of trade unions have to be reckoned with on questions of wages and working conditions.

THE ECONOMIC SITUATION.

As it existed at the time of the Committee's appointment and as it has since developed.

12. We recognise that the present inquiry was instituted in consequence of the abnormal industrial depression and extensive unemployment prevailing at the time of our appointment, and in the hope that we might be able, as the result of our examination of the financial aspect of the problems involved, to devise if not remedies at least aids to recovery. The situation in the closing months of 1929 was already sufficiently grave. But the difficulties with which we were then faced were to a great extent peculiar to this country and were not shared by the world at large. Since the date of our appointment, however, the position has changed both in kind and in degree, and there have supervened upon our domestic difficulties grave disturbances of the economic world as a whole. This change of circumstances has necessarily altered the focus of our inquiry, as the domestic problem has tended to be overshadowed by the international situation. Nevertheless, however much we may attribute the aggravation of our industrial depression and unemployment to what it has now become popular to call "world causes," there remain in the background those domestic causes which at the time of our appointment had already brought about the grave result of over a million unemployed and which, if not remedied, will continue to operate in our own case even if those "world causes" are redressed.

13. If we turn first to the position existing when we were appointed, we apprehend that the tendency then, and since, to attribute the prevalent distress to monetary policy was largely due to an impression that the return of this country to the gold standard in April, 1925—itself one of the turning points in the post-war economic history of the world—had impeded instead of promoting our economic recovery from the consequences of the War, and to a suspicion that there had been a failure to utilise to the full such opportunities to expand credit as were still available notwithstanding the unchallengeable fact that our standard of value had once again become an international one. Not only was the adequacy of the volume of credit created called in question, but the efficacy of the means of its distribution was also the subject of adverse discussion. It may, indeed, be said that at no time since the termination of the historic disputes which followed the Napoleonic Wars and which led to the passing of the Bank Act of 1844 has the monetary organisation of our country been the subject of so much criticism as in recent times.

14. Apart from the development of this critical attitude, the economic position of this country during the five years succeeding the return to the gold standard was such as of itself to render

indispensable an examination of the facts and forces at work. We are far from suggesting that equilibrium had been attained before the return to the gold standard was effected. Indeed in the last year preceding that step, with an insured population between the ages of 16 and 64 of some 11.1 millions, unemployment never fell below a million and for the greater part of the year exceeded 10 per cent., while during the five succeeding years to the end of 1929 the volume of unemployment showed no substantial diminution. However caused, the existence in our midst of this great mass of unemployed persons profoundly disturbed the public mind, representing, as it does, a form of economic waste by its very nature irrecoverable. If the net output per worker be taken as in the neighbourhood of £200 per annum, the national loss from the unemployment of a million men over a period of five years may be estimated at a thousand million pounds. But this was not the only alarming phenomenon. Our export trade, although not completely stagnant, failed, even after making all allowance for changing price levels, to maintain its progress and lost ground in comparison with our competitors; the wholesale price index showed a continually falling trend; and the Bank of England found itself frequently resisting a tendency to lose gold. Meantime our population continued to increase, taxation was maintained at a level higher than in any other country, the national expenditure, with the consequent burden on industry, was being constantly added to by the policy of successive governments, and as a result of the fall in the price of imports the general standard of consumption remained substantially unaffected notwithstanding the economic depression.

15. These features of the period immediately preceding our appointment were sufficiently ominous to cause grave anxiety among those who appreciated their tendency. But it so happened that our appointment coincided in point of time with the beginning of a series of further economic events of an unprecedented character, leading to a state of world depression which shows at this moment few signs of coming to an end. It will suffice here to summarise these occurrences under the following main heads:—

(i) The heavy and rapid fall in wholesale prices affecting all countries alike. Within 15 months from June, 1929, wholesale prices fell 13 per cent. in the United States, 15 per cent. in the United Kingdom, 14 per cent. in France, 9 per cent. in Germany, 11 per cent. in Italy, 15 per cent. in Australia, 11 per cent. in Canada, and 20 per cent. in British India.

(ii) The general spread of unemployment to nearly all the other countries of the world. In three countries alone, Great Britain, Germany and the United States, there were at the end of 1930 probably from twelve to fourteen million persons wholly or partly unemployed.

(iii) The diminution of international long-term lending which may be regarded as partly a cause and partly an effect of the visible deterioration in the position of the raw material producing countries. Interacting with the fall in wholesale prices this has sharpened the severity of the crisis through which the debtor nations have been passing.

(iv) The abandonment of the gold standard in one country after another, e.g., Australia and Argentina, following upon the financial crisis, with the result of increasing the unwillingness to lend to those countries.

(v) The restriction of the process of investment, and consequently of enterprise, due to depreciation of securities and the uncertainty of the outlook, which has had the effect of causing resources to be held as far as possible in liquid form.

These events have been accompanied in many countries by serious political and social unrest which has in turn aggravated the crisis by diminishing their credit and deterring lenders. They have been unfolding themselves throughout the period of our meetings and we refer to them here only for the purpose of showing the far-reaching character of the phenomena with which we have been confronted and the complexity of the situation with which we have had to deal. We shall, of course, return to a detailed examination of them in subsequent chapters.

16. Not the least difficult part of our task has been to endeavour to ascertain how far the crisis through which we are passing is due to monetary causes and how far to other causes. Unfortunately there are no general principles universally accepted as to the mode in which monetary institutions and activities affect the economic situation, still less as to the precise degree of their importance as compared with other causes. Indeed we have been presented with a range of opinion which at one end attributed the whole trouble to monetary causes and at the other entirely absolved them, a divergence of view no doubt attributable in part to varying conceptions of what are monetary causes. Among the non-monetary causes their relative importance *inter se* is itself a subject of acute controversy upon which it is not necessary for our purpose to pronounce. It may well be, however, that in many instances the complaints which have been directed against our monetary system have been occasioned by the fact that it has been asked to perform feats quite beyond its compass. In the case of nations, as in the case of individuals, no financial system, however devised, can work miracles nor can it cope with all the problems which may be presented to it by an unsound national policy, whether internal or external. The financier is not to blame if the politician sets him problems which no financial expedients

can solve. If our budgetary position is unsound, and if our industries, owing to the level of their costs, or for other reasons, are unable successfully to compete, as they used to do, in the markets of the world, no management of the terms and quantity of credit will be able to maintain our national prosperity.

17. While the non-monetary causes which have contributed to the present distress, strictly speaking, fall outside the scope of our inquiry, we have found it impossible to avoid some discussion of them, for it is only by estimating their effect that we can arrive at some delimitation of the sphere of action of monetary causes properly so-called. We have, therefore, attempted in a series of chapters to describe and analyse the principal events and forces, both monetary and non-monetary, which appear to us to have a direct bearing upon our investigations.

CHAPTER II.—GENERAL CHARACTERISTICS OF MONETARY SYSTEMS.

18. Some common unit of value in terms of which transactions can be expressed is necessary, if only as a satisfactory measure for comparing the value of one thing with that of another. With the growth of contractual obligations, involving the conception of deferred payments, a time element was imported into transactions which rendered it even more essential to have a common unit of value as the basis on which to fix the amount of payments to be made at a postponed date. When a community, in order to meet this requirement, selects a particular commodity such as gold to serve as its common denominator of value, or, in other words, as its money, that commodity is used not only for the actual settlement of debts but is also naturally adopted as the unit for the measurement of those debts. It becomes what is termed the money of account, e.g., the pound, the dollar, the franc. But the person entitled to a future payment fixed in terms of the money of account may find, if there is instability in the purchasing power of money due to fluctuations of prices, that the value of his contractual right has substantially changed when he comes to receive payment. The importance of stability in the value of money, that is, in its purchasing power, thus becomes at once apparent if transactions are to be entered into with any degree of confidence.

19. It is important to realise the wide range of contractual obligations which are now affected by fluctuations in the value of money. The policy of modern States has greatly added to their number by the institution of social services which all involve future payments on a predetermined scale. Old Age Pensions, Insurance Allowances and other forms of assistance are all fixed by the Legislature in terms of money which, when it comes to be paid, may represent something quite different in value from what it represented when it was originally prescribed. The growth both of joint stock enterprise and of Government debts has also in the course of the past century enormously increased the number of fixed future money payments. Rights and interests in fact all tend to become more and more divorced from the underlying substratum of real things and are not merely expressed in terms of money but are actually constituted by the right to receive money payments. It is thus obvious that changes in the value of money may give rise to important changes in the distribution of the national income. We return in Chapter X to some of the difficulties thus occasioned.

20. The nature of the changes which the monetary system itself has been undergoing cannot be better illustrated than by the alteration in the emphasis placed by economic science upon the two functions which money is traditionally regarded as fulfilling—the

function of acting as a medium of exchange and the function of acting as a standard of value, or, as it used to be put, as a common denominator of value. Victorian economic theory emphasised the first, modern theory emphasises the second, of these functions. This is significant of more than a mere change of academic fashion. Whereas in the nineteenth century, the symbols (pound sterling, dollar, etc.), which expressed values corresponded to coins actually in circulation, this is not often the case in the modern world. To an ever-increasing extent, paper representatives of the monetary unit constitute the hand-to-hand currency in circulation. The symbolic character of the monetary unit has emerged into the foreground while its relation to some actual physical material has receded.

21. Moreover, in the course of the past and the present century, the importance of hand-to-hand currency has been steadily diminishing. Although its absolute amount grew with the trade and population of the world, its relative importance as the means of settling debts of all kinds at the same time declined. For international payments, even from a very early period, metallic money was little used, and credit instruments in the shape of bills of exchange were largely employed in its place. Before the development of modern banking institutions, indeed, internal remittances were largely effected by means of bills, whilst in the course of the eighteenth and nineteenth centuries the bank note and Government paper money became increasingly important. But, contemporaneously with the development of paper money as a circulating medium, there also developed methods of economising cash either by means of "giro" transactions in the books of banks established for this very purpose at great commercial centres such as Amsterdam and Hamburg, or by the use of written transferable orders on bankers, i.e., cheques drawn against "running cash," the English equivalent of the Continental "giro" system. In the modern world payments are effected by cheques or similar means to a far greater extent than by cash, though the extent to which substitutes for cash are employed varies in different countries. Thus the mass of purchasing power in a modern community is still further removed from the physical objects with which it is linked through the monetary unit.

22. The devices mentioned above are very important in that they have given great elasticity to the volume of purchasing power. When the reserves of purchasing power of each individual were held separately in the shape of current coin, what amounted in the aggregate to a large amount of money was necessarily withheld from active use. Under modern banking conditions, such reserves are entrusted to the banks, and it is the function of the banker to employ in granting loans the amounts which experience teaches him are not likely to be demanded immediately by their

owners. If no additional in-payments were made by customers and there were no withdrawals in cash, the volume of deposits of a single banker would fluctuate only with the volume of the loans he himself made, and the limit of his loans would therefore be fixed by the size of the cash reserve he deemed it necessary to keep. When the lending powers of the banking system as a whole are being considered, however, allowance has to be made for the circumstance that individual banks lose cash, not only to their customers in consequence of demands over the counter for wage and other payments usually made in that form, but to one another, if the cheques drawn on them by their customers in favour of customers of other banks are in excess of the cheques drawn on other banks in favour of their customers. The cash reserves of the banks take the form largely of deposits at the Central Bank, and if the different banks make a point of maintaining a constant ratio between their deposits and their cash reserves (whatever that ratio may be) then the additional lending capacity of a single bank, due to a greater proportion of the aggregate cash reserves passing to it in consequence of favourable clearing balances, will be offset by the smaller lending capacity of all those banks which have been losing cash to it through the clearing. If, however, the aggregate of cash reserves is increased, or if all the banks together decide to reduce the proportion of their cash reserves simultaneously, increased lending will thereby be made possible; though the additional loans thereby justified will only assume their ultimate form gradually. An increase in the deposits of a single bank, accompanied by an increase in its cash reserve due to gold imports or to an increase in the volume of bankers' cash through credit operations of the Central Bank designed to have this effect, will, in the first instance, lead, through adverse clearing house balances, to part of the additional reserve passing into the hands of other banks. As they in turn expand their loans, again part of the additional reserves which they have previously gained will pass over to other banks, until, in the end, the increased reserves are spread over the system as a whole, supporting a larger volume of loans and deposits. Again, a single bank which voluntarily lowers the proportion of its reserve to its deposits will impart an upward movement to the volume of credit by *not* restricting credit as it loses cash through the operations of the clearing. The volume of bankers' loans is elastic, and so therefore is the mass of purchasing power, but there is a time lag involved before the factors which lead to an expansion exercise their full influence.

23. The banking system thus forms the vital link between the two aspects of the complex structure with which we have to deal. For it relates the problems of the price level with the problems of finance, since the price level is undoubtedly influenced by the

mass of purchasing power which the banking system creates and controls, and by the structure of credit which it builds upon the basis of available supplies of gold. Thus, questions relating to the volume of purchasing power and questions relating to the distribution of purchasing power find a common focus in the banking system.

24. If the money income of the community were constant in amount, stability of individual prices would be assured only if all goods and services were being produced in forms exactly corresponding to the way in which the owners of income were disposing of this income. Even the stability of average prices would imply equilibrium between consumers' goods and the instrumental goods necessary for their production. But in addition to these factors affecting the stability of prices, the money-income of the community is itself a variable quantity. If Governments pursue an inflationary policy, i.e., meet expenditure not out of revenue or loans, but by the issue of paper money; or if there is an increased output of gold from the mines, adding to the incomes of gold producers and to the lending powers of the banking system; or if, finally, the banks pursue an easier credit policy and lend more freely to the business community, forces are set in motion increasing profits and wages, and therefore the possibility of additional spending arises. The effects upon the price level are complicated by the fact that the distribution of money-incomes may be altered and the rapidity with which they are spent. Thus, apart from an absolute rise in the price level, relative prices may be distorted and a new direction given to the mechanism of production. In short, an expansion of credit and of currency, however arising, has a complex effect upon the price level.

25. The characteristic modern feature of great banks of deposit, investing their funds largely in short-dated commercial loans is historically recent. Before joint stock banking arose the field was already occupied (i) by the private banker, dealing in international bills of exchange, handling bullion and foreign exchange transactions, and issuing Government and other loans to the public, the predecessor of the modern "merchant banking" firms; (ii) by institutions created with special powers and privileges granted in return for loans to Government, the prototypes of our modern Central Banks; (iii) by the old country banks mostly possessing the right of note issue; and (iv) in certain countries by special banks intended to facilitate mercantile transactions in an age of great currency disorganisation, the "giro" banks of the great commercial cities. It was not until the middle of the last century that joint stock organisations for deposit banking, discounting, or the handling of securities began to come into existence.

owners. If no additional in-payments were made by customers and there were no withdrawals in cash, the volume of deposits of a single banker would fluctuate only with the volume of the loans he himself made, and the limit of his loans would therefore be fixed by the size of the cash reserve he deemed it necessary to keep. When the lending powers of the banking system as a whole are being considered, however, allowance has to be made for the circumstance that individual banks lose cash, not only to their customers in consequence of demands over the counter for wage and other payments usually made in that form, but to one another, if the cheques drawn on them by their customers in favour of customers of other banks are in excess of the cheques drawn on other banks in favour of their customers. The cash reserves of the banks take the form largely of deposits at the Central Bank, and if the different banks make a point of maintaining a constant ratio between their deposits and their cash reserves (whatever that ratio may be) then the additional lending capacity of a single bank, due to a greater proportion of the aggregate cash reserves passing to it in consequence of favourable clearing balances, will be offset by the smaller lending capacity of all those banks which have been losing cash to it through the clearing. If, however, the aggregate of cash reserves is increased, or if all the banks together decide to reduce the proportion of their cash reserves simultaneously, increased lending will thereby be made possible; though the additional loans thereby justified will only assume their ultimate form gradually. An increase in the deposits of a single bank, accompanied by an increase in its cash reserve due to gold imports or to an increase in the volume of bankers' cash through credit operations of the Central Bank designed to have this effect, will, in the first instance, lead, through adverse clearing house balances, to part of the additional reserve passing into the hands of other banks. As they in turn expand their loans, again part of the additional reserves which they have previously gained will pass over to other banks, until, in the end, the increased reserves are spread over the system as a whole, supporting a larger volume of loans and deposits. Again, a single bank which voluntarily lowers the proportion of its reserve to its deposits will impart an upward movement to the volume of credit by *not* restricting credit as it loses cash through the operations of the clearing. The volume of bankers' loans is elastic, and so therefore is the mass of purchasing power, but there is a time lag involved before the factors which lead to an expansion exercise their full influence.

23. The banking system thus forms the vital link between the two aspects of the complex structure with which we have to deal. For it relates the problems of the price level with the problems of finance, since the price level is undoubtedly influenced by the

mass of purchasing power which the banking system creates and controls, and by the structure of credit which it builds upon the basis of available supplies of gold. Thus, questions relating to the volume of purchasing power and questions relating to the distribution of purchasing power find a common focus in the banking system.

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25. The characteristic modern feature of great banks of deposit, investing their funds largely in short-dated commercial loans is historically recent. Before joint stock banking arose the field was already occupied (i) by the private banker, dealing in international bills of exchange, handling bullion and foreign exchange transactions, and issuing Government and other loans to the public, the predecessor of the modern "merchant banking" firms; (ii) by institutions created with special powers and privileges granted in return for loans to Government, the prototypes of our modern Central Banks; (iii) by the old country banks mostly possessing the right of note issue; and (iv) in certain countries by special banks intended to facilitate mercantile transactions in an age of great currency disorganisation, the "giro" banks of the great commercial cities. It was not until the middle of the last century that joint stock organisations for deposit banking, discounting, or the handling of securities began to come into existence.

26. But underneath the diversity of functions assigned to the various classes of financial institutions, there may be discerned certain general features which may be summarised as follows:—

(i) Every advanced financial organisation possesses a market in which funds available only for very short periods are lent out. This is designated the call-loan market. The immediate effect of an increase in the supply of credit is usually an increased flow of funds to this market, whether, as in New York, it is primarily associated with the Stock Exchange, or whether, as in London, it is primarily associated with the market in bills of exchange, i.e., the discount market.

(ii) Every organised system possesses a market in which the supply of and the demand for short-period loans is balanced. To bring short-period lending into relation with short-period demands for accommodation is the primary function of commercial banks.

(iii) Every organised system includes a market for the adjustment of the supply of and the demand for new long-period capital. This is the capital market in the ordinary sense of the term, which prepares and offers new securities to those seeking opportunities for investment.

(iv) In addition, and as an inevitable accompaniment of the capital market, there must be an organisation capable of transferring ownership rights in already existing securities. This organisation is the Stock Exchange.

(v) There are usually special organisations dealing with the supply of savings of a special character, or linking up the flow of savings with the demand for savings for special purposes. Into this category fall the insurance companies, the savings banks, agricultural mortgage banks and other analogous institutions.

27. If the multifarious character of these functions, and of the agencies which perform them, is borne in mind the question of co-ordination naturally arises. How is it possible to attain equilibrium between forces of so diverse a character? In the first instance, of course, equilibrium is attained, as in every market, through the medium of rate or price; if the whole system is in equilibrium, then there will be a definite relationship between the rates of interest or the price of loans in every one of these markets, and between these rates and the expected return on long-period capital. Moreover, since the financial structure of every country influences, and is influenced by, the financial structure of other countries, the whole system of money markets will be in a position of mutually determined equilibrium. Since under an international gold standard international prices tend to a common level; since, further, price movements are influenced by events in the money markets, and the money market is influenced by price

movements, a self-determining equilibrium of all the factors, national and international, is attainable, given a sufficiently long period of time, and the absence of disturbing causes. Thus variations in the rate of interest charged appear to be the appropriate instrument to bring about harmony.

28. Considerations such as these lay at the back of the long-drawn controversies between the supporters and opponents of what used to be called " Free Trade in Banking " in the middle of the nineteenth century. By that time, however, it had already become clear that there resided in the financial structure a tendency not only to harmony but also to disharmony. The necessity for some agency, capable of acting as a brake upon the system, was gradually recognised. The institution called upon to keep the financial structure upon an even keel is the Central Bank : in this country the Bank of England. Historically the principles of central banking were established empirically long before they received theoretical formulation. That there is a distinction between the code of behaviour appropriate to a commercial bank and that appropriate to a Central Bank was recognised as early as 1797, was a bone of contention between practical authorities for nearly three-quarters of a century thereafter, and was finally established with unanswerable brilliance and cogency by Walter Bagehot in 1873. We mention this long struggle to show how recent, even in the case of Great Britain, is the full realisation of all that is involved in the theory of central banking.

Functions of a Central Bank.

29. Since freedom of issue of paper money may easily, under the stimulus of the desire to make profit, lead each issuer to expand until the total amount in circulation is inconsistent with the retention of a sufficient reserve of gold, it is clear that the Central Bank should possess a monopoly of note issue, and this is indeed the almost universal practice of the modern world. But this does not of itself secure to the Central Bank control over the volume of credit, the modern substitute for hand-to-hand currency. This came about in our country through the following causes. It is to the interest of every commercial banker that, in the short run, his reserves should be as small as possible consistently with safety. It is equally to the advantage of each banker that there should be one institution carrying a large reserve available for the use of all in moments of emergency, provided that this institution is willing to utilise its reserve for the common safety when the emergency does arise. Hence the one-reserve system, the foundation of all central banking practice, arose in this country to meet a practical need and found its organ in the Bank of England. The immense importance of this system has had to be recognised, in newer areas in which commercial banks preceded the institution of central banking, by the system of compulsory reserve-deposits

at the Central Bank. Once the commercial banks of a country hold their reserves in the shape of deposits at the Central Bank, the possibility of control by the Central Bank arises. For an expansion of credit by the Central Bank has the effect of increasing the reserve-deposits of the commercial banks at the Central Bank, and a restriction of credit by the Central Bank decreases these reserve-deposits. In the first case the commercial banks can expand, in the second they are sooner or later forced to contract, their own loans. These results follow whether or not the expansion or contraction of credit is effected by the Central Bank through operations in the money market, or through operations in connection with the commercial banks themselves, i.e., whether the Central Bank acts by means of "open market operations" or by means of "re-discounting" for the commercial banks.

30. The Central Bank should, therefore, possess four rights: the right of note issue, the right to hold the reserves of the commercial banks, the right to buy and sell securities, and the right to discount. In return, it must so manage its operations as to be able at all times to meet the demands which may be made upon it, that is, it must be able to safeguard its cash reserve.

In practice the tasks which have been imposed upon the Central Bank make it imperative that it should hold the account of the Government, for the financial operations of Government are conducted on a scale so great as seriously to derange the money market unless special measures are taken to counteract the inconveniences which result from the inflow of revenue or the temporary easiness which results from interest and dividend payments. This task ought to devolve upon the Central Bank in virtue of its general function as guardian of the money market, and does in fact devolve upon it when it carries the Government account.

31. It follows that the functions of a Central Bank and the obligations resting upon it are of a very special character, calling for skill, experience and judgment of a kind different from those which must be possessed by commercial bankers. No banker can neglect the rules of prudence and of safety, but the object of a commercial banker is to make a profit. The situation of the Central Bank is such that it must often undertake operations which are not only not profitable, but result in losses. Its aim must be the safety of the financial system and the economic welfare of the country.

32. These differences of standpoint and function are reflected not only in the powers, but also in the constitution, of the Central Bank. The frame-work of its scheme of government, the general powers conferred upon it, as well as the standards to which, in the exercise of its powers, it is expected to work, are usually embodied in legislation, which in addition to setting a time limit to the privileges conferred upon the Bank, normally subjects the institution to some special limitation upon the disposition of its profits,

either by directing that they shall be used in specified ways, or by limiting the total amount which may be distributed, or by combining directions such as these with appropriation of profits in part by the State.

33. In the sphere of Central Bank legislation two tendencies may be observed. The first concerns the degree of elaboration of the constitutional code by which the Bank is to be governed. There are what may be called the British and the Continental traditions in these matters: the first leaving the Bank much more free to develop its constitution in accordance with changing circumstance, and limiting the degree of State interference to a minimum: the second regulating machinery in detail, emphasising the subordination of the Bank to the organs of the State, and admitting some, in certain cases much, State participation in the affairs of the Bank itself. Such detailed regulation is explicable in many cases on the ground that the Bank has been set up in an environment generally favourable to State paternalism or under circumstances, such as a disorganisation of the currency, which made detailed regulation appear advisable. Nevertheless, rational consideration of the problem will show that a Central Bank which is able to adjust itself to new necessities and exigencies without requiring an amendment of its constitution or powers on every occasion when innovation is considered desirable possesses the inherent advantages which an elastic structure has over a rigid one.

34. The other tendency to which allusion must be made refers to the reserve requirements of modern Central Banks. In the earlier bank constitutions, in so far as a statutory cash reserve was provided for, it was against the volume of the note issue that the reserve was to be held. The magnitude of the reserve was either to be the same as the outstanding volume of notes (subject to a certain minimum of notes which need not be covered) or was to be a certain minimum percentage of the notes outstanding, whilst the reserve itself was to be composed of gold bar or gold coin actually in vault. The deposits of the Central Bank were not subject to regulation. Contrasting the present with the former situation, we note some significant differences: (i) whilst the tendency to insist upon a minimum ratio (generally 35 per cent. or 40 per cent.) still exists, there is a tendency to assimilate deposits to notes for reserve purposes, (ii) the reserve need no longer consist exclusively of gold bar or gold coin in vault, but may consist, to a greater or less extent, also of gold bars or coins ear-marked and held at some other Central Bank and of foreign bills of exchange or bank deposits, payable in gold or held in some country upon a gold standard, (iii) where notes and deposits are statutorily convertible upon demand, the Central Bank is no longer obliged to meet these demands in gold coin, but in gold bars or foreign exchange, and in minimum amounts sufficiently large to prevent a frivolous use being

made of the power of conversion. The effect of these measures may be shortly summed up. In so far as notes and deposits have both to be protected by a statutory reserve, the net amount of reserve to be kept increases. In so far as substitutes for gold, instead of gold itself, can be kept in reserve, the net demand for gold for reserve purposes can diminish if Central Banks in practice make full use of the opportunities of the reserve regulations. Finally, experience has shown that, where a Central Bank is required to maintain its reserves at a certain minimum percentage figure of its outstanding liabilities, the maintenance of such a minimum ratio offers no adequate barrier to a rapid growth of its liabilities in periods of expansion, whilst, at the same time, if it is found necessary subsequently to contract credit, the degree of contraction required, in order to comply with the law, is greater than would have been the case if no fixed relation between cash reserve and liabilities had existed. These provisions have therefore an important relation to the question of the economy of gold which we discuss elsewhere in our Report.

CHAPTER III.—THE INTERNATIONAL GOLD STANDARD.

35. To restore gold to its old position as an international standard of value was the avowed aim of currency policy for a period of six or seven years after the cessation of hostilities. This aim was endorsed by two International Conferences, that of Brussels (1920) and Genoa (1922). Since the restoration of the gold standard the main preoccupation of currency authorities has been with the manner in which it has worked and the extent to which, under the conditions actually experienced, it has been responsible for the present degree of international disequilibrium.

36. By an international gold standard is to be understood not identity of the currency arrangements of all the countries comprising the gold standard group but the possession by all of them of one attribute in common, namely that the monetary unit (i.e. pound sterling, dollar, franc, mark and so on) should possess a gold value prescribed by law, or, rather, a gold value within the limits of the buying and selling price of gold of the local Central Bank. In almost all countries gold coin has now been withdrawn from circulation and its place taken by paper representatives of the gold. The gold price of the paper representatives of gold is determined by the limits at which the Central Banks will give gold for paper, or paper for gold. Thus in Great Britain an ounce of standard gold, containing eleven parts of gold to one part of alloy, is legally equivalent to £3 17s. 10½d. This is the price at which the

Bank of England must sell gold in exchange for its own notes : the minimum price at which it must give its own notes in exchange for gold is £3 17s. 9d.

37. The legal determination by each of a group of countries of the gold equivalent of the monetary unit, though an essential, is not the only condition of an effective international gold standard. Something more is necessary; namely, the right freely to import gold and to tender it in unlimited quantities to the Central Bank; and the converse right, freely and in unlimited quantities, to draw gold from the Central Bank and to export the gold so obtained. During and immediately after the War there were countries which, though nominally, were not actually, on the gold standard because the rights in question did not exist. Thus in Great Britain, although the holder of Bank of England or of Currency notes was legally entitled to obtain gold in exchange for notes, he was, under war conditions, unable in practice to export gold and was later by statute prohibited from exporting it except under licence. Again, in Sweden, gold importers were not free to tender gold in unlimited quantities to the Central Bank: the Swedish krona therefore possessed a value superior to the weight of gold which it nominally represented.

38. The right to demand gold in exchange for local purchasing power, or local purchasing power in exchange for gold, is not, however, the only guarantee of the effective working of the gold standard. It is sufficient if the local currency is exchangeable for another currency which is itself convertible into gold. It is possible indeed to classify currency systems based upon the gold standard by the extent to which the relationship between the local monetary unit and gold is proximate or remote. First there are the systems in which the monetary unit is itself a gold coin; then come currency systems in which conversion takes the form of the exchange by the Central Bank of gold bars into local currency or vice versa; more remote still is the connection when the conversion right takes the form of an exchange of local purchasing power into foreign currency which is itself convertible into gold bars or gold coin. Nor is it absolutely necessary that the right to convert should be conferred by statute; it suffices if the currency authority never refuses to give gold or the equivalent at a fixed rate for the local currency, and vice versa.

Primary Objective of the Gold Standard.

39. The primary object of the international gold standard is to maintain a parity of the foreign exchanges within narrow limits; this has the effect of securing a certain measure of correspondence in the levels of prices ruling all over the gold standard area. Incidentally it provides an objective test of the correspondence of local currency policy with that of the rest of the world, whilst

under it the currency mechanism itself provides the resources by which, in the event of temporary disequilibrium in the relation of one currency to another, equilibrium can be restored. But although so long as an international gold standard exists, the currency authority of any gold standard country has always a simple test of the effect of its policy constantly before it, the disequilibrium between the local currency in relation to the rest of the world leading to a loss of gold may be due to deep-seated causes which, if not corrected by measures involving a definite change in values in the country in question, would result in a permanent drain of gold, or alternatively it may be due to a merely temporary deficiency in the balance of payments, not in itself due to deep-seated currency derangements. A sudden check to exports due to the failure of a crop in an exporting country, or a sudden weakening of markets in an importing country, or pressure on the foreign exchange market due to a demand for remittance in consequence of a rush of new long-term issues in the capital market, or the withdrawal of short-term balances from a money market in consequence of political unrest in the borrowing or lending country, or indeed, in any part of the world, are instances in point. What is necessary is the possession of some one exportable commodity, the value of which will not fall, i.e., for which the short-period price is not subject to change. Gold is such a commodity; so also is the exchange represented by a draft on a bank of the creditor country. Gold and foreign exchange reserves are easily mobilisable assets which are available at moments of emergency, when perhaps nothing else is available. Thus, under the international gold standard, the currency system itself provides the resources by means of which equilibrium can be restored, so long as the causes by which disequilibrium has been brought about are only temporary in character, and so long as the international gold standard is itself maintained.

40. The fact that a state of temporary disequilibrium can be adjusted by flows of gold or foreign exchange does not remove from the currency authority the necessity of caution and of interpreting the situation in the light of its fundamental duty of safeguarding the international standard. What appears at first sight to be a case of purely temporary disequilibrium may prove to be a symptom of a more deep-seated lack of adjustment. Whilst gold exports need not be followed by more drastic remedial measures if the disequilibrium is temporary, they are always a warning both to the money market and to the Central Bank itself that further action may later be necessary. Thus, whenever gold is lost, the Central Bank is provided with an "automatic" signal of the emergence of conditions which may make positive action necessary. The ultimate aim—the restoration of the international value of the currency—is clear, but the action to be taken, and the precise moment at which it should be taken, remain in the sphere of

discretion and judgment, in a word with "management". That the sphere of "management" in this sense is wide and responsible is beyond doubt. For if the wrong action is taken, the state of disequilibrium which the monetary authority designs to correct may be accentuated or perpetuated. If, in a state of temporary disequilibrium, the monetary authority takes action resulting in a change in the level of values here, a new state of disequilibrium may be unnecessarily created. The sense in which the gold standard can be said to be automatic is thus very limited; it is automatic only as an indicator of the need for action and of the end to be achieved.

Secondary Objectives of the Gold Standard.

41. It may be considered a secondary object of the international gold standard to preserve a reasonable stability of international prices. The mere existence of an effective international gold standard does not, however, guarantee stability of prices as a whole either over space or over time. In the nineteenth century, indeed, price movements in different gold standard countries showed a marked tendency to move together, but the absolute level of prices showed a considerable degree of long-period instability. And in the post-war period the sympathetic movement of prices over space is subject to a much greater degree of interference than was the case before the War, whilst the trend of prices over time has shown a very marked degree of instability. These circumstances call for investigation.

42. If prices are to be kept in approximate equality over space, two sets of conditions, which must be present simultaneously, are necessary. In the first place, countries which are losing gold must be prepared to act on a policy which will have the effect of lowering prices, and countries which are receiving gold must be prepared to act on a policy which will have the effect of raising prices. In the second place, the economic structure (as distinct from the currency structure) must be sufficiently organic and sufficiently elastic to allow these policies to attain their objective. The first condition concerns central banking policy: the second limiting condition is not a question of monetary policy, but of the actual economic conditions in which such policy has to work. In practice, it may easily happen that where the first condition is present, the second is absent, and vice versa.

43. The nineteenth century philosophy of the gold standard was based on the assumptions that (a) an increase or decrease of gold in the vaults of Central Banks would imply respectively a "cheap" or a "dear" money policy, and (b) that a "cheap" or a "dear" money policy would affect the entire price structure and the level of money-incomes in the country concerned. But, in the modern post-war world, neither of these assumptions is invariably valid. The

growth of the practice of Central Banks, by which gold inflows or outflows are offset by the withdrawal or creation of bank credit—the movement of gold not being allowed to produce any effect on monetary conditions—involves not the absence of policy, but a policy inconsistent with the rapid adjustment of relative money-incomes and prices. Thus, if at a time when gold flows freely to the United States the Federal Reserve System offsets gold imports by sales of securities, thereby preventing credit expansion, the level of American money-incomes and prices will not rise. If, at the same time, the levels of European money-incomes and prices are already higher than international equilibrium justifies, the whole burden of re-adjustment will be thrust exclusively on Europe. Again, if the level of British costs is out of line with international conditions, but gold exports are offset by the creation of fresh credit by the Bank of England, the maladjustment will continue. Both the failure of American incomes and prices to rise, and the failure of British incomes and prices to fall, may be deliberately intended, but in that case a policy of stabilising local values has been, implicitly or explicitly, substituted for a policy of maintaining a level of values consistent with international equilibrium.

44. Moreover, the effect of the policy of a Central Bank is uncertain when the general economic structure is itself rigid, and more particularly so when the object of that policy is to reduce the price level and the income structure. Pressure can be brought to bear upon the users of credit by a restriction of credit or the raising of bank rate, but that pressure cannot be directly brought to bear upon the costs of production. If the economic structure is rigid, then the effect may be to depress wholesale prices but to leave other prices unchanged, and the process of restoring incomes and prices to an equilibrium level through gold flows and associated bank policy may be interrupted or long delayed or even completely obstructed.

45. The degree to which the price level remains stable over a period of time is again profoundly influenced by policy. If gold were the only form of currency, if there were no alternative uses for gold, and if no stocks of gold were held by Central Banks, the price level would be directly affected by the habits of the community on the one hand and the output of gold on the other. Actually, in the modern world, gold plays in the main only an indirect rôle in the determination of the price level, because the circulating media consist overwhelmingly of paper money and bank deposits; it is this volume of purchasing power which directly affects the price level and not the amount of gold which may be held in reserve. Gold itself affects the price level mainly through the decisions of the holders of gold reserves as to the amount of purchasing power which they will allow to be outstanding against a given holding of gold. Central Banks and currency authorities as a whole can increase their total reserves only to the extent of the new gold supplies available each year for currency purposes. An

acute competition for gold in order to increase reserve ratios tends to a reduction of the aggregate amount of purchasing power against which the gold is held, and to a fall in prices additional to the fall which would in any case have taken place if, in a period of falling supplies of gold, a rigid relationship between gold supplies and additional supplies of purchasing power had been maintained, i.e., if reserve ratios had been left unchanged. In a period of expanding trade production and population, a decreased gold supply, unless accompanied by a similar movement of reserve ratios, lowers prices. If, in addition, certain countries take steps to obtain gold solely for the purpose of increasing the ratio of their gold to their liabilities, the price level must fall still more. It falls more because the countries successful in the struggle do not allow their additional supplies of gold to affect their prices, and because the countries which are threatened by a loss of gold take steps to resist the loss which have the effect of lowering their prices.

Conditions necessary for the working of the Gold Standard.

46. The international gold standard is intended to subserve the general ideal of stability—as regards the relations between currencies, and price relationships over space and time—but it does not, in and of itself, guarantee that this ideal will be realised. The international gold standard can, under appropriate conditions, enable both exchange stability and a considerable degree of price stability to be attained simultaneously, over a wide area, but, the mere fact that the standard is gold, and that it is international, will not under all conceivable conditions and varieties of policy, automatically bring about these results. In other words, there are “rules of the game,” which, if not observed, will make the standard work with undesirable, rather than beneficial, consequences.

47. It is difficult to define in precise terms what is implied by the “rules of the game.” The management of an international standard is an art and not a science, and no one would suggest that it is possible to draw up a formal code of action, admitting of no exceptions and qualifications, adherence to which is obligatory on peril of wrecking the whole structure. Much must necessarily be left to time and circumstance. Central Banks, in whose hands the working of the international gold standard has been vested, no doubt largely recognise that in many respects the purely traditional and empirical rules by which their conduct was guided in pre-war days are no longer adequate as guides of action in present day conditions, and we consider that the following principles would be generally accepted:—

(i) The international gold standard system involves a common agreement as to the ends for which it exists.

(ii) It should be an object of policy to secure that the international gold standard should bring with it stability of prices as well as that it should guarantee stability of exchange.

(iii) Action by individual Central Banks which, by repercussions on the policy of the others, imperils the stability of the price level should, as far as possible, be avoided.

48. The direct influence of Central Banks upon the price level is exerted through an alteration of the volume of purchasing power brought about by changes in bank rate or by variations in the volume of assets held by them. But there is also an indirect influence exerted by Central Banks to which considerable importance must be attributed. Changes in the level of bank rate affect the price, and therefore the yield, of investment securities. In periods of low bank rate the price of fixed-interest-bearing securities tends to rise, and their yield to fall. The supply of such securities is therefore gradually encouraged because the cost of borrowing is lower whilst at the same time the demand for them is increased once confidence has returned in any degree. Long-term funds are thereby placed at the disposal of Governments and entrepreneurs and the process of real capital formation is stimulated, with the result that a rise of general prices is engendered. It may even be held that the indirect effect of easier conditions in the money market is more important as an intermediate link in the chain of events which leads from acute depression to the gradual restoration of confidence than the direct effect of attempting an expansion of the volume of purchasing power. For a Central Bank has no assurance that the net amount of purchasing power in existence will in fact be increased by the steps which it may take to that end. Its own operations in the market, through purchases of securities, may for instance lead to a repayment to it of loans previously made by way of discounts; the net amount of purchasing power would then perhaps remain unchanged. The investment market, and particularly the international investment market, thus occupies a place of great importance among the agencies determining price changes.

CHAPTER IV.—THE MONETARY SYSTEM OF GREAT BRITAIN.

49. In Chapter II we indicated that the Central Bank of the country must possess four rights:—

- (a) the right of note issue;
- (b) the right to hold the reserves of the commercial banks;
- (c) the right to buy and sell securities; and
- (d) the right to discount.

In giving a brief description of the monetary system of this country, it is mainly on those rights, and the machinery through which they are exercised, that we shall concentrate.

1. THE BANK OF ENGLAND.

50. The Bank of England is almost unique as a Central Bank in that it is a private institution practically independent of any form of legal control save in regard to its powers of issuing bank notes and granting loans to the State. Its foundation in 1694 arose out of the difficulties of the Government of the day in securing subscriptions to State loans. Its primary purpose was to raise and lend money to the State and in consideration of this service it received under its Charter and various Acts of Parliament, certain privileges of issuing bank notes. The corporation commenced with an assured life of twelve years after which the Government had the right to annul its Charter on giving one year's notice. Subsequent extensions of this period coincided generally with the grant of additional loans to the State. Finally by the Bank Act of 1844 the privileges of the Bank were continued subject to termination by twelve months' notice and subject to the repayment of the debt amounting to £11,015,100 due to the Bank by the State.

51. Apart from statutory provisions regulating the issue of notes, the grant of loans to the State and the publication of a weekly account, Sir Ernest Harvey informed us that "the Bank of England is practically free to do whatever it likes with one exception There is only one real prohibition that is imposed upon the Bank, and that is in the Tonnage Act of 1694, which says that in order not to oppress His Majesty's subjects the Bank is to be debarred for all time from using any of its funds in dealing in merchandise or wares of any description." (Q. 62). "The restrictions, so far as there are restrictions, under which the Bank works in its operations are restrictions which the Bank has imposed upon itself and which, of course, it has the power to alter." (Q. 71).

The Note Issue.

52. For many years subsequent to 1694, the Bank of England remained the sole banking institution in England and Wales with more than six partners possessing the legal right to issue notes. The Bank gradually acquired an effective (though not a legal) monopoly of the note issue in London, and through its relations with Government, a privileged position in conducting deposit banking. Not until 1826 was legislation passed permitting the formation of other banks of issue with more than six partners, but this relaxation was subject to the restriction that such banks should not be established, or issue notes, within a distance of 65 miles from London. In 1833 the notes of the Bank of England were given the status of legal tender: by the same Act it was declared that companies, although consisting of more than six persons, might carry on the business of banking in London and the surrounding area, but

such companies were debarred from issuing notes payable on demand. Finally the Bank Act of 1844 for the first time brought the note-issuing powers of all banks under complete legal control.

53. Under the Act of 1844 it was provided that the issue of notes by the Bank of England should be kept wholly distinct from the banking business of the Bank. The amount of notes allowed to be issued was fixed at £14 millions to be covered by securities (i.e., the fiduciary issue), and such further amount as might be covered by gold coin, gold bullion, or, to a limited extent, silver bullion. At the same time the powers of note issue of the country banks were restricted to those banks already possessing the right of issue, and the volume of notes which they might issue was limited to the average amount actually in circulation over a stated period of twelve weeks. Further, it was provided that the right of issue possessed by those banks should lapse in certain contingencies, such as amalgamation with a non-issuing joint stock bank or an increase in the number of partners above six. Upon such a lapse the Bank of England was entitled to increase its fiduciary issue by two-thirds of the amount of the lapsed issue. By 1921 the whole of the private issues had in fact lapsed with the result that the fiduciary issue of the Bank of England was eventually (in 1923) raised to £19,750,000.

54. In connection with the separation of the note issue business from the banking business, the Act of 1844 directed that there should be transferred, appropriated and set apart to the Issue Department securities to the value of £14 millions (of which the debt due by the State to the Bank was to be deemed a part) and so much of the gold coin and gold and silver bullion then held by the Bank as was not required by the Banking Department. The Issue Department was required to deliver to the Banking Department such an amount of Bank of England notes as, together with bank notes then in circulation, was equal to the aggregate amount of securities, coin and bullion transferred, and the whole of the note issue was deemed to be issued on the credit of the securities, coin and bullion so appropriated and set apart to the Issue Department. Apart from the minor provisions regarding the lapsing of private issues, the Bank had thus no power to increase the volume of notes in any way but by the acquisition of further gold. In emergencies, when the demand for cash exceeded the Bank's powers of payment, the course which was adopted was for the Prime Minister and the Chancellor of the Exchequer to communicate with the Bank promising to lay proposals before Parliament for authorising an excess note issue should the Bank find it necessary to go beyond the statutory limits of issue.

55. The currency in circulation and in bank reserves thus consisted, except for the fiduciary issue of the Bank of England and the issues of the private and country joint stock banks in England,

together with those of certain Scottish and Irish banks of issue (which were not legal tender), entirely of gold and subsidiary coin or of notes backed by gold. Thus legal tender currency could only be increased by the acquisition of additional gold. In the early stages after 1844 the use for the settlement of transactions of means of payment other than legal tender currency was relatively limited, but the rapid growth of the joint stock banking system led to the development of the cheque drawn against sums deposited in, or loans granted by, a joint stock bank. The mechanism under which those banks made credit available to customers and the limitations on the volume created will be described later; it is sufficient here to indicate that the use of the cheque introduced into the monetary system the possibility of greatly expanding the amount of the country's purchasing media, legal tender currency being required in the main only for the payment of wages and retail transactions, for pocket money, and for such part of the joint stock banks' cash reserves as they hold in their own custody.

56. During the War the Currency and Bank Notes Act of 1914 authorised the issue of Bank of England notes in excess of the limits fixed by law to such extent as might be temporarily authorised by the Treasury and subject to any conditions attached to that authority. But the important change in practice was that during the War and for ten years afterwards currency notes for £1 and 10s. were issued by the Treasury, the amount and manner of the issues being entirely within the discretion of that department.

57. It is unnecessary to trace here the processes by which during the War both the deposits in the joint stock banks and the currency note issue were greatly expanded; these matters are dealt with in the Report of the Cunliffe Committee which enquired into Currency and Foreign Exchanges after the War (Cd. 9182 of 1918). So far as concerns the note issue that Committee considered it to be imperative that the issue of fiduciary notes should, as soon as practicable, be once more limited by law, and the currency notes and Bank of England notes amalgamated into a single Bank of England issue. They favoured the principle of a fixed fiduciary issue embodied in the Act of 1844, subject to the continuance of the provisions of the Act of 1914, under which the Bank of England could, with the consent of the Treasury, temporarily issue notes in excess of the statutory limit.

58. As regards the amount of the fiduciary issue the Cunliffe Committee recommended that, as a temporary expedient, pending final arrangements, the actual maximum fiduciary circulation in any year should become the legal maximum for the following year. The Committee considered that without further experience it would be dangerous to lay down a precise figure for the fiduciary issue and

recommended a review of the position when the foreign exchanges had been working normally for a period of at least a year on the basis of a minimum gold reserve of £150 millions. These recommendations were accepted generally by successive Governments, and following the report of the Committee on the Currency and Bank of England Note Issues, 1925, there was enacted the Currency and Bank Notes Act, 1928, whereby the note issues were amalgamated as one issue under the control of the Bank of England. By this Act the new fiduciary issue was fixed at £260 millions, this figure being approximately the amount of the actual maximum fiduciary issue of Bank of England and Treasury notes for 1927, subject to a small deduction in respect of the circulation in the Irish Free State which was being replaced by a Free State issue of notes.

59. While the Act of 1928 maintained the principle of the fixed fiduciary issue of the 1844 Act, it at the same time gave power to the Treasury, on the application of the Bank of England, to assent to an increase or reduction of the amount of the fiduciary issue, subject, in the case of an increase, to the conditions that any such authority (i) should run for a period not exceeding 6 months and (ii) might be renewed or varied on the representation of the Bank but not so as to remain in force (with or without variation) for more than two years without the sanction of Parliament. Any authority for an increase of the fiduciary issue was directed to be laid before Parliament.

60. The eight Scottish joint stock banks still possess powers of note issue. They may issue notes pound for pound against legal tender cover held at two approved offices or held by the Bank of England on their account, and in addition each bank has a fiduciary issue of fixed amount. The total authorised fiduciary circulation for the Scottish banks is £2,676,350 while the average circulation is usually somewhat over £20,000,000. A similar position exists in regard to certain banks in Northern Ireland for which the fiduciary circulation was fixed by the Bankers (Northern Ireland) Act, 1928, at £1,634,000 (subject to a period for the reduction of the previously existing fiduciary issues to that level). We were informed by Sir Ernest Harvey that at the time of his evidence (November, 1929) the average amount of Bank of England notes set aside as cover to the note issues of banks in Scotland and Northern Ireland was about £24,500,000 (Q. 132).

61. Apart from these small issues, the Bank of England is at the present time the sole note issuing authority of the country, subject to the legal requirement that notes in excess of £260 millions require to be covered pound for pound by gold. Against the fiduciary issue the Bank is required to hold securities to an amount sufficient in value to cover it. These securities may include silver coin to an amount not exceeding £5½ millions; apart

from this, they are interest-bearing securities. From the income yielded by the securities held against the fiduciary issue there have to be met the expenses of printing, issuing and cancelling notes and the general expenses of management; the amount of the net profit, ascertained in such manner as may be agreed between the Bank and the Treasury, is payable to the Treasury as public revenue. In practice this allows for the appreciation or depreciation of the values of the securities held. The nature of the securities held by the Issue Department is left to the decision of the Bank of England.

62. The Act of 1928, although it greatly enlarged the amount of the Bank of England's fiduciary issue, and imported a measure of elasticity into the issue through the power conferred on the Treasury to authorise a temporary increase in the fiduciary issue, confirmed as a normal arrangement the essential provision of the Act of 1844 by which variations in the amount of the note issue depend upon the stock of gold held by the Bank, the amount being increased or decreased as gold flows in or flows out. Practically all the gold held by the Bank is concentrated in the Issue Department and notes are issued up to the full amount of the assets of that department. Notes so issued but not actually in circulation are held in the Banking Department of the Bank and the amount of those notes together with the coin is the measure of the cash held against the liabilities of that department to the public.

The Banking Department.

63. The Issue Department is thus concerned solely with the issue of bank notes up to the legal maximum. The Banking Department on the other hand, is a bank of deposit, the position of which can be best understood by a brief reference to the nature of the liabilities and assets of the department. Its liabilities comprise the Proprietors' Capital of £14,553,000; the Rest (or undistributed profits), which is not normally allowed to fall below a figure of £3,000,000; and the liabilities of the Bank to its clients which are shown under the heads of Public Deposits, Other Deposits (subdivided into Bankers' Deposits and Other Accounts), and a small amount of seven day and other bills.

64. The Public Deposits include all balances of the British Government held at the head office and branches of the Bank, including the Exchequer Account, the Paymaster General's account from which supplies are issued to the spending departments and many accounts in connection with the National Debt, the collection of taxation and Government funds of various types.

65. The Bankers' Deposits relate exclusively to British banks whose main business is conducted in this country. The balances of other banks, such as British banks operating in the main in the

Dominions (including the Bank of Ireland) and in foreign countries fall into the "Other Accounts." The latter head also includes balances maintained by foreign Central Banks, Colonial Banks, merchant banks and financial houses, Indian and Colonial Governments, and the dividend accounts of the stocks managed by the Bank other than the direct obligations of the British Government.

66. Against these liabilities the Bank holds assets consisting of—

(i) "Government Securities" under which fall only direct obligations of the British Government, including Treasury Bills acquired on the initiative of the Bank and not presented to it for discount, and any temporary Ways and Means Advances made to the Exchequer.

(ii) "Other Securities" divided under two heads, viz. :—

(a) "Discounts and Advances," which comprises bills of exchange and Treasury bills brought to the Bank for discount, and advances made by the Bank to the bill market and to private clients, and

(b) "Securities," which may include stocks guaranteed by the British Government, Indian, Colonial or foreign securities, miscellaneous securities, and commercial bills purchased by the Bank on its own initiative.

(iii) Bank notes issued by the Issue Department but not in circulation. The notes in circulation include not only notes actually in the hands of the public but also notes in the tills and reserves of other banks, and notes set aside as cover for the note issues of banks in Scotland and Northern Ireland to the extent to which those issues exceed limits prescribed by Parliament. The average amount of Bank of England notes so set aside is normally about £23,000,000 to £24,000,000.

(v) Gold and Silver Coin which consists almost entirely of silver coin.

The ratio which the Bank of England notes held in the Banking Department, together with coin, bears to the total of Public and Other Deposits and post bills is generally known as "the Proportion".

67. The reserve of notes in the Banking Department is in effect the measure of the maximum amount of gold which the Bank could part with in the absence of a change in the volume of notes in circulation, unless the powers of extending the fiduciary issue are used. In practice, of course, it could not be allowed to sink to zero. If for any reason there is a drain of gold from the country the Bank must therefore take steps to correct the situation which has given rise to that drain before its gold stock is too seriously affected. As regards the stock of gold which the Bank might desire at any time to hold, Sir Ernest Harvey said in evidence before us :—

"I think it is fair to say that the Bank of England do not carry any fixed figure in their mind as at all times an adequate figure of

gold. It must be obvious that the sufficiency of the gold held must depend upon the changing circumstances of the moment—what is the period of the year?—is it a period of the year when we may be subject to considerable withdrawals from abroad?—what are the liabilities which we know to lie ahead of us?—what, so far as we can measure, are the claims upon us by foreign countries which they might enforce at any moment? We have never considered, I think, that the Cunliffe Committee, in mentioning £150,000,000, did more than consider a figure which in normal circumstances and having regard to the fact that gold in the pockets of the people had been replaced by notes would be a fair average figure, may I say. It is obvious that at one moment £150,000,000 might be sufficient, whereas at another moment it might be insufficient. We are not wedded to the figure of £150,000,000 in the least. I think there is good evidence of that in the fact that we have allowed the figure to be brought down. There is, however, one fact which must always be borne in mind. Whatever the figure named as the minimum below which we should not fall, the lower you put it the less our power of resistance in case of any crisis. The lower, therefore, you allow the figure to fall the more necessary it may be at times to take rather drastic measures for the curtailment of credit—for the maintenance of a comparatively high, or at any rate effective, rate. But we are not wedded to any figure. We judge the figure according to the circumstances of the moment, and in our judgment so far as we were able to estimate the circumstances of the time we considered that it was not unreasonable to allow that figure of £150,000,000 to be reduced to the figure at which it now stands.” (Q. 152).

68. If, however, circumstances arise such as to call for positive action by the Bank to prevent a drain of gold, or to encourage the importation of gold, the means which the Bank has at its disposal is an alteration in the level of the bank rate—the minimum rate of discount at which the Bank will discount certain types of bills for the discount market—in combination, if necessary, with open market operations, i.e., the purchase or sale of securities by the Banking Department, or it may be only with an alteration in the types of securities so held without alteration in their total amount.

69. As regards the circumstances in which one of these methods might be employed in preference to the others, Sir Ernest Harvey stated: “I find it rather difficult to attach in general any order of importance to those methods. As regards the first . . . the mere movement of the rate, the exact effect cannot be determined beforehand—at least it is very difficult to do so with any certainty. You know that if you put up the Rate one per cent. you will produce a certain effect upon rates. But the extent of the effect and whether it will hold or not depends upon a great many other circumstances. The relative importance of the different methods is entirely dependent upon the circumstances existing at the

moment. . . . The mechanism of tightening up rates by a market operation of some kind would be the natural method to use, if, in our view, the existing Bank Rate which, if effective, would be high enough, had for some reason or other become ineffective." (Q. 7519). As regards the use of the two types of market operation, "I think our first operation would normally be to reduce the volume of credit by the sale of bills." (Q. 7520). "Unless we had clear evidence that there was a margin of credit which could only find employment in the short loan market, we should not necessarily effect any reduction in the volume of credit. If we do reduce the volume of credit in order to make the rate effective, it is only because we are satisfied that the reason for the weakness of the market rate is an excess of money which cannot find employment elsewhere than in the short market." (Q. 7521).

70. We discuss in Chapter XI the consequences which follow from Bank policy as exercised through the bank rate and open market transactions; here we are concerned only with the mechanism. An alteration in the level of bank rate may, as we have already indicated, be made for the purpose of correcting an outflow of gold due to a temporary disequilibrium in the balance of international payments. In such a case it may produce the desired result by its effect on international movements of short-term capital without any marked effect upon the internal position of this country. Or it may be designed to correct deep-rooted disparities in the price level in this country as compared with other countries, in which case it may have to be continued until the altered price for the use of money restrains or expands demand as the case may be. The mechanism by which this effect is transmitted is that by custom the clearing banks vary certain rates of interest, charged or allowed, by reference to the level of bank rate. While these normal rates are subject to many exceptions in practice, the general position (with occasional deviations) is that:—

(a) the rate of interest allowed by the clearing banks on London deposits repayable at short notice is 2 per cent. below bank rate;

(b) the rate of interest charged on loans and overdrafts is $\frac{1}{2}$ per cent. to 1 per cent. above bank rate, with an agreed minimum of commonly 4 to 5 per cent.;

(c) the rate of interest charged by the clearing banks on call money to the discount market is somewhat above the rate paid on London deposits.

Thus an increase of bank rate brings with it an increase in the rates both for short money and for bank loans. It works both on the international position by attracting funds to this country or preventing funds from moving outwards, and on the internal position by discouraging borrowing from the commercial banks and so tending to a reduction of their deposits.

71. But the Bank also holds at command the power directly to increase or decrease the amount of purchasing media in the country by open market operations. If the Bank purchases securities in the market the transaction is settled by crediting the drawing account of the broker or other party through whom they are purchased. This eventually leads to an increase in the balances of the joint stock banks at the Bank of England. The Bank's holdings of securities will of course have been increased by the same operation. The deposits of the joint stock banks at the Bank are the equivalent of cash and the banks thus find themselves with more than their usual proportion of cash to deposits and are in a position to grant further loans to their customers or otherwise to create additional credit. Since the banks as a whole maintain a cash proportion to deposits of from 10 per cent. to 11 per cent. they are in fact able to increase their deposits by some 10 times the cash created by the Bank of England. By the opposite process a sale of securities by the Bank of England or the calling in of a loan will reduce the cash of the joint stock banks and entail a reduction of their deposits. The Bank of England is thus in a position (provided that it has knowledge of the variations in the note holdings of the joint stock banks) to exercise almost complete control over the amount of bankers' cash in the country, and thus, given the conventions which govern the transactions of the joint stock banks, over the total volume of deposits within such limits as are set by the existence of the international gold standard. The bankers' cash may, of course, be reinforced by gold imports without action on the part of the Bank of England but it is within the power of the Bank to take steps to offset any expansion in deposits which might thus arise.

72. There are normally no direct borrowing or lending transactions between the Bank of England and the joint stock banks. The connection is established through the discount market, which we consider later. That market employs funds lent to it by the joint stock banks (as well as other institutions, British and foreign) at call or short notice. If a joint stock bank or other lender finds its cash position is below normal, it withdraws call money from the discount market. That market, if it cannot supply itself with necessary funds from other banks or other sources, brings bills to the Bank of England for discount or borrows from the Bank on the security of bills or Government securities, thus again increasing the cash basis.

2. THE JOINT STOCK BANKS.

73. The joint stock banks, or deposit banks, are the banks with which the public in general deal. They carry out many familiar services for their customers but we are concerned mainly with their functions as recipients of deposits and as lenders to trade and industry, the financial market and other borrowers, and the mechanism which governs generally their operations.

74. It is not unnatural to think of the deposits of a bank as being created by the public through the deposit of cash representing either savings or amounts which are not for the time being required to meet expenditure. But the bulk of the deposits arise out of the action of the banks themselves, for by granting loans, allowing money to be drawn on an overdraft or purchasing securities a bank creates a credit in its books, which is the equivalent of a deposit. A simple illustration, in which it will be convenient to assume that all banking is concentrated in one bank, will make this clear. Let us suppose that a customer has paid into the bank £1,000 in cash and that it is judged from experience that only the equivalent of 10 per cent. of the bank deposit need be held actually in cash to meet the demands of customers; then the £1,000 cash received will obviously support deposits amounting to £10,000. Suppose that the bank then grants a loan of £900; it will open a credit of £900 for its customer, and when the customer draws a cheque for £900 upon the credit so opened that cheque will, on our hypothesis, be paid into the account of another of the bank's customers. The bank now holds both the original deposit of £1,000 and the £900 paid in by the second customer. Deposits have thus increased to £1,900 and the bank holds against its liability to pay out this sum (a) the original £1,000 of cash deposited and (b) the obligation of a customer to repay the loan of £900. The same result follows if the bank, instead of lending £900 to a customer, purchases an investment of that amount. The cheque which it draws upon itself in payment for the investment is paid into the seller's bank account and creates a deposit of that amount in his name. The bank, in this latter case, holds against its total liability for £1,900 (a) the original £1,000 of cash and (b) the investment which it has purchased. The bank can carry on the process of lending, or purchasing investments, until such time as the credits created, or investments purchased, represent nine times the amount of the original deposit of £1,000 in cash.

75. The process is much the same when we remove the assumption that there is only one bank. The credit granted by one bank may reach the accounts of customers in another bank. There is thus established a claim by the second bank upon the first for cash, and the ability of the second bank to grant loans is improved in so far as that of the first bank is reduced. Over the banking system as a whole therefore, loans and investments made by the banks increase their deposits. There is, however, a limitation on this process. A bank which is actively creating deposits in this way will naturally find that a considerable part of the cheques drawn against them will be in favour of other banks. It will thus lose part of its cash reserve to those banks and must proceed to limit its loan operations if its normal cash ratio is to be maintained. In practice, therefore, no one bank can afford to pursue a policy

of creating deposits by making loans or investments which is much out of line with the policies of other banks.

76. The cash which the banks hold is partly in the form of bank notes and coin maintained in tills and reserves to meet current demands by customers and for exigencies, and partly in the form of a deposit with the Bank of England—the bank of the bankers. The latter credit affords first the means of settling day to day balances between banks and secondly the means of obtaining any further supplies of notes or coin that they may need for current use. A further cash item is represented by balances with other banks and cheques on other banks in course of collection. These claims on other banks, which are settled within a day or two, usually amount to about $3\frac{1}{2}$ per cent. of the deposits, varying of course with the amount of business done by the bank.

77. For the ten London clearing banks, the division between the cash in hand and the balance at the Bank of England was as follows for the years 1919 to 1930. The figures are the annual averages of the monthly figures supplied to us by the banks :

			£ mills.		Proportion to Current and Deposit Accounts* (average for year.)		
			Cash in Hand.	Balance at Bank of England.	Cash in Hand.	Balance at Bank.	Total Cash.
1919	...	...	112.4	103.9	7.4	6.9	14.3
1920	...	...	106.8	83.7	6.2	4.9	11.1
1921	...	...	110.7	96.1	6.3	5.5	11.8
1922	...	...	107.5	92.9	6.3	5.4	11.7
1923	...	...	103.8	87.3	6.4	5.4	11.8
1924	...	...	103.8	88.3	6.4	5.5	11.9
1925	...	...	103.7	86.2	6.5	5.4	11.9
1926	...	...	103.1	86.1	6.4	5.4	11.8
1927	...	...	105.1	85.3	6.3	5.1	11.4
1928	...	...	104.5	83.6	6.1	4.9	11.0
1929	...	...	104.4	82.9	6.0	4.8	10.8
1930	...	...	103.6	84.5	5.9	4.9	10.8

* These percentages differ somewhat from those shown by the published monthly statements of the Clearing Banks for the reasons stated in the notes to Appendix I.

78. The figures included in the monthly statements are the average of the aggregates of the figures of each bank on its weekly "make-up" day. There are in fact four different days of the week on which the banks compile their weekly balance. Thus if one bank improves its cash position on the make-up day at the expense of the cash position of the remaining banks, it follows that

the monthly statement would not reflect the true daily cash position of the banks as a whole. Since the end of 1928 the Bank of England has shown separately in its weekly account the actual Bankers' Balances as on Wednesday of each week and a comparison of the two returns throws considerable light upon the true cash position.

79. The Bank of England figure covers a wider group of banks than the ten clearing banks whose figures are shown above. Nevertheless, if we exclude the larger balances maintained at the end of each half year, it shows that for 1929 the Bankers' Balances averaged on each Wednesday about £62 millions and for 1930 about £63 millions. If we take the clearing banks' figures (excluding the half yearly figures) the average balance at the Bank of England works out at about £77 millions for 1929 and £78 millions for 1930. It is evident, therefore, that the clearing banks do not maintain from day to day so high a proportion of cash as is shown by the monthly statements, and although we have not available all the data required to make an exact calculation, it seems probable that the balance maintained by those banks (excluding the half yearly periods) is appreciably below £60 millions or less than $3\frac{1}{2}$ per cent. of deposits. It is probable therefore that the total cash reserve kept (apart from balances with other banks and items in transit), is over all about $9\frac{1}{2}$ per cent, against the published figure of nearly 11 per cent.

80. Behind the actual cash reserves the banks maintain a volume of assets which are readily realisable in case of need to meet withdrawals. In order of liquidity these are :—money at call and short notice lent to the bill market and to a small extent the Stock Exchange, usually about 7 per cent. or 8 per cent. of deposits; bills of exchange and Treasury bills, usually about 13 per cent. to 15 per cent. of deposits; and investments consisting mainly of a mixture of short-dated and long-dated bonds and stocks (largely British Government securities), usually about 16 per cent. of deposits. The remaining large item on the assets side consists of the debts of the customers of the banks in respect of the loans and advances granted to them by the banks, the normal percentage of which varies for different banks between 50 and 55 per cent. of deposits.

81. The following table of the percentages which the various assets (other than cash) bore to deposits in the years since 1919 shows how closely these percentages have been adhered to by the banks as a whole; though it may be that minor accounting changes conceal or account for small variations. As between individual banks, there are, however, fairly substantial variations in the proportions in which their assets are divided. The percentages are calculated from the annual averages of the monthly figures given in Appendix I.

Proportions to Current and Deposit Accounts.

	Money at Call.	Money at Short Notice.	Bills.	Investments.	Advances.
1919	1.5	7.2	17.6	23.3	38.4
1920	1.4	4.4	15.1	21.4	48.4
1921	1.6	4.2	20.4	19.9	45.1
1922	1.7	4.8	18.8	24.6	41.7
1923	1.5	5.2	16.5	23.4	45.2
1924	1.5	4.9	14.3	22.6	47.9
1925	1.5	5.7	13.6	19.1	51.3
1926	1.6	5.9	13.0	17.7	53.3
1927	1.5	6.9	12.7	16.4	54.2
1928	1.7	7.3	13.2	16.1	54.0
1929	1.7	6.9	12.7	15.8	55.5
1930	1.9	6.2	14.7	16.2	53.6

We add a further table showing the total deposits of the ten clearing banks in each year since 1919 and the division of this total into current accounts payable on demand and deposit accounts payable after date or notice, together with the proportions of each to total deposits.

	Total Deposits.	Current Accounts.	Deposit Accounts.	Proportion of Current Accounts to total.	Proportion of Deposit Accounts to total.
	£ mill.	£ mill.	£ mill.		
1919	1510.7	1015.9	494.8	67.2	32.8
1920	1719.7	1097.6	622.1	63.8	36.2
1921	1753.6	1024.7	728.9	58.4	41.6
1922	1707.4	998.3	709.1	58.5	41.5
1923	1614.1	965.6	648.5	59.8	40.2
1924	1615.7	950.0	665.7	58.8	41.2
1925	1602.7	922.5	680.2	57.6	42.4
1926	1608.9	921.4	687.5	57.3	42.7
1927	1658.6	932.1	726.5	56.2	43.8
1928	1708.9	953.7	755.2	55.8	44.2
1929	1738.0	940.1	797.9	54.1	45.9
1930	1740.8	920.8	820.0	52.9	47.1

82. On the general question of the proportions in which the banks normally divide their assets we may quote from the evidence given by Mr. Hyde :—

“ We must bear in mind that our deposits are in a very considerable part payable on demand, and even those deposits that are fixed for a period may be payable on demand by arrangement with the depositor ” (Q. 866). This puts the banker under an obligation to keep available an amount of cash “ which is very

the monthly statement would not reflect the true daily cash position of the banks as a whole. Since the end of 1928 the Bank of England has shown separately in its weekly account the actual Bankers' Balances as on Wednesday of each week and a comparison of the two returns throws considerable light upon the true cash position.

79. The Bank of England figure covers a wider group of banks than the ten clearing banks whose figures are shown above. Nevertheless, if we exclude the larger balances maintained at the end of each half year, it shows that for 1929 the Bankers' Balances averaged on each Wednesday about £62 millions and for 1930 about £63 millions. If we take the clearing banks' figures (excluding the half yearly figures) the average balance at the Bank of England works out at about £77 millions for 1929 and £78 millions for 1930. It is evident, therefore, that the clearing banks do not maintain from day to day so high a proportion of cash as is shown by the monthly statements, and although we have not available all the data required to make an exact calculation, it seems probable that the balance maintained by those banks (excluding the half yearly periods) is appreciably below £60 millions or less than $3\frac{1}{2}$ per cent. of deposits. It is probable therefore that the total cash reserve kept (apart from balances with other banks and items in transit), is over all about $9\frac{1}{2}$ per cent, against the published figure of nearly 11 per cent.

80. Behind the actual cash reserves the banks maintain a volume of assets which are readily realisable in case of need to meet withdrawals. In order of liquidity these are:—money at call and short notice lent to the bill market and to a small extent the Stock Exchange, usually about 7 per cent. or 8 per cent. of deposits; bills of exchange and Treasury bills, usually about 13 per cent. to 15 per cent. of deposits; and investments consisting mainly of a mixture of short-dated and long-dated bonds and stocks (largely British Government securities), usually about 16 per cent. of deposits. The remaining large item on the assets side consists of the debts of the customers of the banks in respect of the loans and advances granted to them by the banks, the normal percentage of which varies for different banks between 50 and 55 per cent. of deposits.

81. The following table of the percentages which the various assets (other than cash) bore to deposits in the years since 1919 shows how closely these percentages have been adhered to by the banks as a whole; though it may be that minor accounting changes conceal or account for small variations. As between individual banks, there are, however, fairly substantial variations in the proportions in which their assets are divided. The percentages are calculated from the annual averages of the monthly figures given in Appendix I.

Proportions to Current and Deposit Accounts.

	Money at Call.	Money at Short Notice.	Bills.	Investments.	Advances.
1919	1.5	7.2	17.6	23.3	38.4
1920	1.4	4.4	15.1	21.4	48.4
1921	1.6	4.2	20.4	19.9	45.1
1922	1.7	4.8	18.8	24.6	41.7
1923	1.5	5.2	16.5	23.4	45.2
1924	1.5	4.9	14.3	22.6	47.9
1925	1.5	5.7	13.6	19.1	51.3
1926	1.6	5.9	13.0	17.7	53.3
1927	1.5	6.9	12.7	16.4	54.2
1928	1.7	7.3	13.2	16.1	54.0
1929	1.7	6.9	12.7	15.8	55.5
1930	1.9	6.2	14.7	16.2	53.6

We add a further table showing the total deposits of the ten clearing banks in each year since 1919 and the division of this total into current accounts payable on demand and deposit accounts payable after date or notice, together with the proportions of each to total deposits.

	Total Deposits.	Current Accounts.	Deposit Accounts.	Proportion of Current Accounts to total.	Proportion of Deposit Accounts to total.
	£ mill.	£ mill.	£ mill.		
1919	1510.7	1015.9	494.8	67.2	32.8
1920	1719.7	1097.6	622.1	63.8	36.2
1921	1753.6	1024.7	728.9	58.4	41.6
1922	1707.4	998.3	709.1	58.5	41.5
1923	1614.1	965.6	648.5	59.8	40.2
1924	1615.7	950.0	665.7	58.8	41.2
1925	1602.7	922.5	680.2	57.6	42.4
1926	1608.9	921.4	687.5	57.3	42.7
1927	1658.6	932.1	726.5	56.2	43.8
1928	1708.9	953.7	755.2	55.8	44.2
1929	1738.0	940.1	797.9	54.1	45.9
1930	1740.8	920.8	820.0	52.9	47.1

82. On the general question of the proportions in which the banks normally divide their assets we may quote from the evidence given by Mr. Hyde:—

“ We must bear in mind that our deposits are in a very considerable part payable on demand, and even those deposits that are fixed for a period may be payable on demand by arrangement with the depositor ” (Q. 866). This puts the banker under an obligation to keep available an amount of cash “ which is very

much more than sufficient to meet any demand that may be made upon us " (Q. 867). " After we have allowed for the £40,000,000 of cash that we keep in absolutely ready form to meet withdrawals we have then to consider how we shall spread the rest of our assets, bearing in mind two principles. First, that we must keep still a large proportion of our assets very liquid so that if there are withdrawals from our cash owing to the shrinkage in our deposits, we can replenish the cash and still maintain very large liquid resources " (Q. 869). " Then the second point is that we have to earn a profit. You can quite well understand that our expenses are heavy . . . therefore we have to see that we use the remainder of our assets as well as we can in making profits. For that reason we distribute our assets over a variety of different forms of employment so as to secure two objects, first of all, liquidity, and, secondly, profits " (Q. 870).

83. With regard to the particular increase which has taken place in the percentage of advances, Mr. Hyde said that while some part of the addition over the normal ratio of the Midland Bank represented their desire to accommodate customers, " part of it represents the fact that at some time in the past our deposits were on a higher plane and we let out part of them to trade and we cannot now, without putting trade to considerable difficulty and inconvenience, get it back from trade immediately. It has got to be a slow process " (Q. 906). Mr. Goodenough attributed the increase largely to the inability of industries which had obtained credit to repay their liabilities (Q. 624).

84. Despite the small variations, the figures we have quoted show a remarkable adherence to the conventional distribution of assets over a period of years, and this feature has to be kept in mind in considering the position of the commercial banks as the distributive agents for credit throughout the commercial, industrial and financial world. Given the maintenance of a certain cash base the banks will always in time expand their deposits to a figure of some nine or ten times that base, but it does not necessarily follow that they can distribute their assets immediately in the proportions at which they normally aim. In certain circumstances it may be, indeed, that the efforts of the bankers to employ their cash remuneratively will set in motion forces which will themselves bring about a reduction of their deposits. The general process may be summed up briefly as follows.

85. A bank has each day to take a view of its general cash position. Loans and advances are constantly being granted and repaid, bills mature every day and investments are being repaid at intervals. If the result of these day to day changes is to show an increase in the cash balance relative to deposits, the bank has to find means of employing its surplus resources at a profit.

Its aim ultimately is to distribute its assets in the normal proportions, but it cannot, for example, at once expand advances to its customers, since it is dependent upon the volume and quality of applications made by would-be borrowers. In the first place, therefore, the bank finds an outlet for its surplus cash, either by lending money to the market or by buying bills or investments. The choice will be dependent largely upon the view taken by the bank as to the liquidity of its position, the nature of the demands which it anticipates in the early future, and the relative profitableness of each type of transaction. The natural outlet in the first instance is, however, the grant of additional loans to the bill market. That market has then an increased volume of funds seeking remunerative employment while nothing has affected the supply of bills for discount. Competition for bills may force the rate of discount down, and though some bills may be attracted to London for discount from other markets, the weakening of the rate may be such as to lead to the possibility of an outflow of gold and thus entail restrictive measures by the Bank of England. It is possible, therefore, that in certain circumstances the cash base may have to be contracted before the banks have had the opportunity of employing their resources in loans to industrial or other borrowers.

86. If, however, such conditions do not arise and the cash base remains unaffected, the general policy of the commercial banks will be to restore the normal distribution of their assets. As and when the demand for advances increases they will be ready to withdraw accommodation from the money market. How far this readiness may affect the actual demand for advances is a matter upon which the views of our witnesses appear to differ. In one case we have been told that the demands for advances for industrial purposes are continually in excess of the ability of the bank to lend; in most cases the evidence we have received is to the effect that the banks have not been compelled, by reason of their cash position, to reject any application for an industrial loan which they regarded as a desirable loan to grant.

87. In general, however, it is clear that the ability of the commercial banks to grant loans to their customers ultimately depends, under existing joint stock banking practice, upon the provision of the necessary cash base by the Bank of England. If the commercial banks have made loans up to that percentage of their deposits which they have adopted as a working basis, either they must cease to grant new loans except to the extent that existing loans are reduced, or the cash base must be expanded by the Bank of England. The determination of what is an adequate supply of credit rests ultimately therefore with the Central Bank. As to the factors upon which the Bank frames its judgment we quote from Sir Ernest Harvey's evidence:—"It is to the joint stock banks that we have

to look for guidance as to the needs of industry for an increased volume of credit or for signs that the volume of credit is in excess of requirements. . . . The barometer to which we look is the volume of money that is seeking investment in the short market, presumably for the reason that, except in so far as additional short assets may be necessary for the restoration of bankers' proportions, the funds in question cannot find employment elsewhere than in the short market We have to look to the volume of the private deposits considered in conjunction with conditions in the money market, and we have to measure on that basis the adequacy of the volume of credit—always, of course, having regard to the external position, the state of our reserve, the position and trend of the exchanges " (Q. 8848).

3. THE ACCEPTING HOUSES AND THE DISCOUNT MARKET.

88. In the British monetary system, these organisations play an important part. In contrast with most other countries, the function of accepting and discounting bills of exchange is very largely performed in this country by highly specialised firms and companies instead of by the commercial banks, although the latter do a not unimportant share of the business. It is unnecessary to enter into a detailed account of the work of these organisations since we are concerned particularly with the manner in which one of them, namely the discount market, as an intermediary between the Bank of England and the commercial banks, acts as the principal user of the short-term funds of the latter.

89. International trade is largely financed by bills of exchange drawn on banks or banking houses. The process may be briefly described by an example. A British importer wishing to import goods from a foreign country will go, say, to his accepting house and ask them to open a confirmed credit in favour of the foreign exporter through some bank in the exporter's country. The exporter, on exporting the goods and obtaining the ship's bill of lading, will attach the latter together with an invoice, insurance policy and any other relevant documents to a draft for the sum due to him drawn on the London accepting house and ask the local bank to discount the bill so that he may receive his money at once. Relying on the confirmed letter of credit and the first-class standing of the accepting house the bank will be ready to do this. It will then send the draft and the documents to its London agent with orders to present it to the accepting house for its acceptance. The draft being accepted, the agent can either hold it for collection till maturity, or discount it at once in the discount market and recoup his principal abroad. The exporter therefore receives his money at once; the importer secures credit for a period; the discounter of the bill abroad obtains an instrument freely negotiable, and the accepting house receives an acceptance commission for the use of its name on the bill, either retaining

the documents until the bill is repaid or, as is often done, parting with them at once to the importer. The risk run by the accepting house is therefore the insolvency of the importer.

90. The details of the transaction will vary with the particular case. The accepting house may stipulate that the importer must give security, either in the form of the relative documents (such as bills of lading, &c.) or some other form, or it will often give a blank credit to a client who is well-known and financially strong. The importer must place the accepting house in funds in time to meet the payment of the bill on its due date. The accepting house does not, therefore, actually provide cash in respect of its acceptances, though it must always be ready to "take up" its acceptances whether or not funds have been received to cover them. Its function is to guarantee due payment of the bill and in this way to make it one which will be readily discounted by banks or by the discount market. For this guarantee it makes a charge which in general varies from one to two per cent. per annum according to the credit of the customer and the character of the risk.

91. We have given as an example the case of imports into this country. But the same system of acceptance may apply to exports from this country or to imports and exports between any two foreign countries. The variations in the type of transactions financed by sterling acceptances are indeed exceedingly numerous. It is very common too—almost a rule, in fact, where a joint stock bank accepts—for the facilities given to be granted by the London acceptor not directly to the foreign client but through the channel and under the guarantee of a foreign bank. A German bank for instance is given by an English bank or accepting house a certain limit of credit which it is free to use for the re-imbusement business of its clients. These clients then finance themselves by drawing sterling bills on London.

92. The world-wide standing of the London accepting houses, in combination with the discounting facilities available and the maintenance of a free gold market, has led to the use of the sterling bill for international transactions in all parts of the world and not only for transactions in which this country is concerned either as importer or exporter. While the mere acceptance of a bill does not involve the immediate financing of trade in cash, bills always tend to be discounted in the market in which they are accepted. If there were no counterbalancing factor the existence of the accepting business would mean that the resources of London were being applied to the financing of a large part of the world's trade. In fact, however, the accepting houses and the joint stock banks hold substantial deposits of foreign money. Sir Robert Kindersley in evidence before us said of his own firm:—
 "My foreign deposits which I lend to the discount market, or

invest in Treasury bills, or use otherwise are equal to the bills drawn upon me, and therefore I get a commission and London is not asked to produce any money for it because the foreign deposits which I have are sufficient to finance the bills" (Q. 1157). He thought also that a very large proportion of those deposits would not be made were it not for the acceptance business (Q. 1158). In his view also this position was likely to be typical of all accepting houses (Q. 1232). On a similar point Mr. Hyde, giving evidence for the Midland Bank, said:—"The total of the deposits that we have from foreign banks, the total money that is placed in London, that can be used in London, is more than twice the total of all our advances and all our acceptances to foreign banks put together. So on balance we get a considerable sum that is being used in advances to home trade—home customers" (Q. 953). These extracts explain one source of the funds which reach the Discount Market.

93. Since this evidence was given we have received from the clearing and certain other banks and from the accepting houses figures showing their total acceptances on foreign account and the amount of foreign money deposited with them or held by them in sterling bills on foreign account. These figures, while not complete, throw considerable light on the position. They will be found in detail in Appendix I (with some notes on their composition) but we reproduce the main items here:

I.—Deposits and Sterling Bills held in London on foreign account.

£ mills.

	30th June, 1927.	31st Dec., 1927.	30th June, 1928.	31st Dec., 1928.	30th June, 1929.	31st Dec., 1929.	30th June, 1930.	31st Dec., 1930.	31st March 1931.
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Held through Bank of England, Clearing Banks, and Scottish Banks.

Deposits ...	123·2	116·8	132·0	139·4	126·4	118·3	171·4	164·6	146·2
Sterling Bills	129·0	161·6	158·5	195·3	190·0	200·2	147·8	144·7	136·8

Held through Accepting Houses, etc.

Deposits ...	76·1	89·3	96·4	104·3	86·4	79·2	88·5	82·1	81·0
Sterling Bills	9·4	13·1	9·1	16·9	14·5	19·4	8·6	8·0	7·4

Advances to Discount Market by certain foreign banks, etc.

Advances ...	38·3	38·4	47·3	47·0	36·5	34·0	42·3	35·1	35·7
Aggregate of Deposits, Bills, etc. ...	376·0	419·2	443·3	502·9	453·8	451·1	456·6	434·5	407·1

II.—*Sterling Bills accepted on foreign account.*

	30th June, 1927.	31st Dec., 1927.	30th June, 1928.	31st Dec., 1928.	30th June, 1929.	31st Dec., 1929.	30th June, 1930.	31st Dec., 1930.	31st March 1931.
By Clearing Banks and Scottish Banks ...	31·4	31·7	38·5	51·3	51·6	40·0	43·2	35·7	32·3
By Accepting Houses, etc.	91·5	108·0	126·9	149·2	150·9	135·7	132·1	125·3	120·6
Total ...	122·9	139·7	165·4	200·5	202·5	175·7	175·3	161·0	152·9

94. The Discount market in London consists of three public companies, with capital and reserves amounting to about £6,215,000, four private companies with a capital of £1,625,000, 17 private firms and 8 running brokers (who act as intermediaries only) with a capital of roughly £8,000,000. For the most part this capital is invested in securities which are used as a guarantee for loans granted by the banks and others. For the bulk of its resources actually employed in discounting bills, the market relies mainly upon direct borrowing from the clearing and other banks, and from accepting houses and other financial institutions, but partly upon deposits made by the public, for which generally interest is paid at $\frac{1}{4}$ to $\frac{1}{2}$ per cent. above the rates paid on deposits by the banks.

95. The loans and advances made by the joint stock banks to the market constitute their second line of liquid assets. For money at call or short notice the banks normally charge a rate of interest somewhat above that paid on bank deposits, but in addition they lend overnight at a lower rate any surplus money which they have in hand as a result of day to day changes in their balance sheet. The discount market is in the first instance therefore largely dependent for its resources upon the volume of the funds which the clearing and other banks and accepting houses have available for use in this way. Should the market be short of money—by the calling in of loans by the banks or by an increase in the volume of bills for discount—it is able to apply to the Bank of England for accommodation. On this aspect we may quote from the evidence of Sir Ernest Harvey:—“At the Bank, our regulations as regards the bills we accept, though they are not governed by any statutes or anything of that kind, are, in fact quite definite, and have been taken more or less as a model by most foreign Central Banks. They are, that the bills should bear at least two good British names, one of which must be the acceptor. The discount market knows that. Of course, the bills may represent, let us say, a sale of cotton by the United States to Great Britain; they

may represent movement of produce from the East to Great Britain; they may also represent movement of produce between two foreign countries which is financed by credit obtained from a British house, and where they accept the bill, although the bill relates to a movement of goods abroad, it is a British acceptor. The market knows that it can always get its accommodation at a price. Of course, I do not mean to say that any member of the discount market can come in and get accommodation to an unlimited extent. The relations between the Bank and the discount market are exceedingly intimate. Seeing the sort of obligation that the Bank accepts towards the discount market, we claim the right to be kept fully informed regarding their position, if need be, to see their balance sheets, and the right—of course in the strictest confidence—to the very fullest information (Q. 365). . . The rate paid by discount houses to banks for short money, call money, of course, has nothing to do with us at the Bank; that is a matter for the banks themselves. . . . It is generally understood that they charge a minimum of about one per cent. below bank rate (Q. 370). . . . There is a lot of other money that is lent on call. What the proportions are it is difficult to say. I have often asked people and I should estimate—I may be quite wrong—that the bankers' call money is probably about 50 or 60 per cent. of the call money in the market. The other call money is call money in the hands of private lenders and if they cannot get such a rate as the bankers will expect to get . . . they will cut the rate at once . . . and that is the call money which may act as a depressing factor on discount rates. But, of course, that is a factor over which we really have no control. . . . The rate at which the discount house can generally sell its bills to the Bank is what is known as bank rate. . . . Advances to the discount market are usually made for periods of a week and at a rate of one-half per cent. over the bank rate. I say usually. There is no rule that absolutely governs it, but that is the usual practice" (Q. 371).

96. From this brief review of the mechanism of our monetary system we may now see the machine as a whole. The Bank of England, as the Central Bank, is in complete control of the creation of the cash base of the country, subject to such limitations as result from the statutory restrictions upon the issue of legal tender money and the obligation to meet demands for the export of gold. As regards the former, however, the provisions of the Act of 1928 permit of the expansion of the note issue by an increase of the fiduciary portion.

97. By its control over the cash base the Bank of England is in a position to regulate the volume of bank deposits, so long

as the joint stock banks adhere to their normal practices in regard to the distribution of their assets, or indeed to offset any change which might be made in those practices. The volume of deposits, in turn, is the approximate measure of the amounts which the commercial banks are prepared to employ in various ways and more particularly, from the point of view of our inquiry, the amount which they are ready to lend to trade and industry if the demand for accommodation is forthcoming. Money so lent and actively employed in production is disbursed in wages and other payments and becomes the incomes of those who will purchase commodities. It is through this relationship that the creation of credit affects the level of prices.

98. The link between the Bank and the commercial banks is established through the discount market which is the first outlet of any surplus funds held by the banks and from which funds are withdrawn when the banks find it necessary to replenish their reserves. If the withdrawal causes a shortage of funds in the market, the market borrows in one form or another from the Bank of England and the accommodation given by the Bank provides the means of replenishing the cash resources of the commercial banks.

CHAPTER V.—THE SPECIAL PROBLEMS OF GREAT BRITAIN.

99. At the time of our appointment the outstanding feature of the trade and industry of this country was that they were not merely depressed, but that they were depressed in relation to the state of the rest of the world. The world-wide depression has since obscured the special characteristics of the British situation, but it is nevertheless an essential part of our task to review the economic condition of this country as it stood during the earlier period.

100. In the first place we must recall the chief characteristics of our economy. We are a small island, crowded with a population of 46,000,000, of whom about 80 per cent. live in towns or urban districts. We have under existing conditions to import 60 per cent. of our food, and, in fact, in 1930 imported altogether articles of the value of £958 millions (excluding re-exports) or £20 17s. Od. per head, a figure high in comparison with most countries. We are enabled to pay for these imports partly because we are a great industrial and exporting country, but—since our commodity exports alone would be insufficient—very largely because, as a great commercial, financial, shipping and entrepôt nation, we draw an income of some £195 millions from the rest of the world in banking, insurance and other commissions, and in shipping freights, and because, by the investment of our past savings abroad, we have built up large foreign assets, from which we draw each year in interest about £270 millions.* We are thus the antithesis of what the economists term a "closed system." We are dependent on very large imports to maintain our standard of living and on very large exports to maintain employment; but to pay for those imports we have become largely dependent on our interest from our foreign investments, and on our profits as international bankers, merchants and so forth. Since 1913 our net imports have increased from £659 millions to £958 millions in 1930, though, as prices have risen and the territory covered has changed, the volume of imports into Great Britain and Northern Ireland increased by 18 per cent. only; our domestic exports, while increasing in value from £525 millions in 1913 to £571 millions in 1930 owing to higher prices, have in volume decreased by about 32 per cent. if changes in the quality of goods are left out of account. While the increase in imports of food and raw materials has helped to maintain our standard of living, the decrease in exports and the increase in imports of manufactured goods have caused much of our unemployment.

101. Before the War we managed to combine, with a standard of living higher than that of almost any other country in the world,

* These figures relate to the year 1929. For 1930 the income from commissions, shipping, etc. is estimated at £160 millions and the income from overseas investments at £235 millions. The figures do not include sinking fund repayments estimated to be of the order of £30 millions per annum.

a flourishing and growing export trade. Although our costs were higher than in most other countries, we were still able to compete, though under a growing pressure from our rivals. We owed this favourable position to the advantage of being the first in the field, of having long had an established position, and of the world evincing a keen demand for our special products. Moreover, we were assisted greatly by the vast sums we lent abroad which were used by the borrowers largely in making purchases in this country.

102. Since the War the situation has greatly changed. We have had of recent years a large and continuous amount of unemployment, heavy direct taxation and a diminishing volume of exports. On the other hand, the standard of living of the employed in certain industries has not only been maintained but considerably raised.

103. This change in our situation took place before the world recession in trade. It cannot, therefore, be attributed to causes affecting the world as a whole, although that is not to say that the causes may not to some extent have been external to this country. The outstanding fact is that up to 1929 we suffered from trade depression in many of our great industries, accompanied by a more or less steady figure of 1,000,000 unemployed, at a time when other countries were enjoying a considerable degree of prosperity. It is not, of course, to be inferred that this mass of unemployment represented continuous unemployment week after week of the same persons. The fluctuations in the composition of the total are large; in 1930, for instance, out of 12 million workpeople insured, nearly 8 millions drew no unemployment benefit at all; and of the remaining 4 millions, the benefit drawn by about 2 millions in no single case exceeded 100 days in all.

104. The fluctuations in the percentage of unemployment in recent years are shown by the following figures (which relate to Great Britain only) compiled by the Ministry of Labour:—

				<i>Total number of insured persons aged 16 to 64. (1st July) (000).</i>	<i>Mean of monthly percentages of unemployed.</i>
1922	...	...	...	10,855	14.1
1923	...	...	...	10,903	11.6
1924	...	...	...	11,061	10.2
1925	...	...	...	11,271	11.0
1926	...	...	...	11,422	12.3*
1927	...	...	...	11,526	9.6
1928	...	...	...	11,629	10.7
1929	...	...	...	11,834	10.3
1930	...	...	...	12,138	15.9

* Affected by general mining stoppage; the figure excludes, however, persons disqualified for benefit by reason of trade disputes.

105. The percentages of unemployment in the principal industries in Great Britain and Northern Ireland for the years 1924 to 1930 published in Statistical Tables relating to British and Foreign Trade (Cmd. 3737) throw up clearly the heavy and continuous unemployment in certain of the basic industries, despite, in some cases, a large reduction in the insured population engaged in those industries. In general engineering, steel-smelting and iron and steel rolling mills, and ship-building—the industries which had been greatly expanded during the War—the insured population, if represented by 100 in 1923, had fallen by July, 1930, to 92.3, 88.7 and 78.6 respectively. Yet, even so, throughout the period unemployment remained much above the average. Coal prospered up to 1924 by the damage to the French and Belgian mines and subsequently by the occupation of the Ruhr. But for the six years 1925 to 1930 this industry, representing about one-tenth of the insured population, has been responsible for about one-sixth of the total unemployment despite a contraction in the insured population in the industry of about 128,000. In later years, cotton (in which the insured population has remained almost constant) and to some extent wool, began to affect the position seriously. Among other industries which show a high average of unemployment are docks, shipping, public works contracting, and building, but in the latter two at any rate the cause is probably mainly the intermittence of employment and short-term fluctuations, accompanied by a substantial expansion in the insured population.*

On the other hand the severity of unemployment has not been very marked in the distributive services, despite an expansion of some 43 per cent. in their insured population since 1923; nor in electrical engineering, printing, or banking and finance.

106. These statistics tend to show that the real unemployment problem in this country is that of continuous depression in some areas and in some industries, which are in fact those in which the economic development of this country has been mainly exhibited in the past. Over a large part of the insured population, certainly more than two-thirds, and probably three-quarters, employment between 1921 and 1930, with the exception of the interruption caused by the coal dispute in 1926, has either been entirely regular, or subject to such slight intermittence that it can be regarded as regular by pre-war standards.†

107. An examination of the position from another angle, that of employment, fortifies this conclusion. Estimates of the number of insured workpeople aged 16 to 64 in employment in Great Britain show the following result.‡

* See Evidence before the Royal Commission on Unemployment Insurance pp. 117-8.

† Ibid, p. 119.

‡ Ibid, p. 116.

Estimated number of insured persons in Employment in Great Britain (excluding persons sick or directly involved in trade disputes).

—	1924	1925	1926	1927	1928	1929	1930
	(Thousands)						
1st Quarter ...	9,360	9,560	9,800	9,840	10,010	10,030	10,020
2nd Quarter ...	9,620	9,610	8,890	10,080	10,050	10,270	9,870
3rd Quarter ...	9,530	9,510	8,460	10,060	9,970	10,300	9,690
4th Quarter ...	9,550	9,710	9,050	10,030	9,990	10,230	9,480

Thus, although there were 900,000 more unemployed at July, 1930, than at March, 1924, there were actually over 300,000 more insured workpeople employed in the third quarter of 1930 than in the first quarter of 1924, and the position throughout 1929 was from this aspect markedly better than 1924. Nevertheless, even in that year, the increase in employment did not keep pace with the increase in the numbers of the insured population.

108. It must, of course, be recognised that the complicated rules which determine what is an unemployed person on the live register of unemployed, and the variations in qualifications for benefit which have from time to time affected the numbers on the register, make it impossible to draw detailed conclusions from this brief sketch of the unemployment position. But, from the aspect of our inquiry, it is important to establish the fact that the mass of unemployment has been, and is, mainly concentrated in the heavy industries, and latterly in certain of the textile trades, all of which figure largely in our export business.

109. The broad inference is that, as Professor Clay put it in evidence before us, the post-war unemployment problem in this country up to 1929 included an element amounting to perhaps 7 per cent. of the insured population which was new and not attributable to the causes which explained pre-war unemployment. This mass of unemployment is attributable directly or indirectly to the War and the disturbance in economic conditions it created by, first, the excessive expansion of the metal, engineering and explosives industries in relation to any probable peace-time demand; second, the interruption of our export trade, dislocating the foreign exchanges and stimulating competitive industries abroad, to the permanent injury of our export industries; and third, the discontinuance, up to the close of the post-war boom period, of the normal and necessary adjustments of industry to the continuous technical, commercial and competitive changes that would have gone on if there had been no war.

110. It is not, of course, to be denied that substantial headway has been made towards the readjustment necessary to meet the changed situation in several directions. Indeed, as the figures of insured workers show, contraction in the coal industry and in several others has already gone far, and war-expanded industries have been relieved of a large part of the excess labour they had absorbed. Essentially, however, throughout the whole period there has been a large problem of labour adjustment to peace-time conditions which in the main was independent of monetary conditions and in itself insoluble by monetary means.

111. In addition to this problem of internal adaptation of war-distended industries to peace-time conditions, certain general changes in world economic conditions, to which we need only refer briefly, have borne heavily upon this country. Pre-war Britain was essentially adapted to supply the world in particular with coal, textile goods and other manufactured articles. But since the War she has had to face the development of the cotton industry in the East; the substitution in a substantial degree of oil and hydro-electric power for coal; the generally less favourable terms on which the agricultural countries of the world have been able to sell their products, affecting not only the demand for our manufactures but also bringing a reduction in domestic agricultural prices; the disorganisation of trade with China and India and many other countries resulting from political and other forms of disturbance, and to a large extent from the fall in the value of silver; the currency disorders in various European countries followed at a later date in some cases by stabilisation of the currencies on a basis which gave a substantial temporary stimulus to their export trades; the growth of tariffs and alterations in tariff policies; and a great development of nationalism.

112. It is beyond question that such a concentration of disturbances, of widely varying type, must impose a great strain on any economic system. They fall obviously with peculiar severity upon a country such as ours of which the economic structure has for many generations been especially developed to support a large volume of international trade, and to conduct, with substantial profit to itself, a major proportion of the world's financial business. Unemployment is inevitably created in some industries. Even in favourable circumstances it can only be absorbed in the more prosperous or in new industries over a period of time during which production is dislocated, and it will only be so absorbed if, in fact, those industries themselves offer to the business man an expectation of profit from his enterprise.

113. Unfortunately, the conditions in this country have not been favourable either to the maintenance of the output of the basic industries at what might reasonably have been expected to be its post-war level or to the development of the less exposed or new

industries. From a period commencing some time after the War, the currency policy of the country was directed to the reduction of the inflated price level of the War and immediate post-war period preparatory to the return to gold. This necessarily involved a reduction of money costs of production. It is probable that equilibrium had not been achieved even prior to the return to gold, and there was, moreover, a marked difference between the behaviour of costs in the so-called sheltered and unsheltered industries. But the return to gold in 1925 itself required the reduction of sterling prices and, consequently, of money costs of production to an extent which is variously estimated. At any rate, the actual situation which was disclosed in the years following the return to gold marks that step as the beginning of a new series of difficulties for our trade and industry. Whatever the disequilibrium between costs and prices which still existed in 1924, it was seriously accentuated by the adjustment of sterling prices to gold prices. If gold prices had continued to rise, as they had been rising just previously, those difficulties would have largely vanished; as it was gold prices fell and the hopes then entertained in that respect were disappointed.

114. It is naturally very difficult to assess our disadvantages in costs of production, and the situation can only be tested by examination from more than one aspect. If it be looked at from the position of wages, which constitute so large a part of the costs of most manufactured products, the Ministry of Labour statistics show that over the whole period 1924 to 1929 money wage rates have remained practically unchanged at 170 to 175 per cent. of the pre-war level. In the period 1st January, 1925, to 1st January, 1930, the cost of living index fell from 180 to 166, or 8 per cent., while wholesale prices fell from 100 in 1924 to 82 in 1929, a fall of 18 per cent. Real wages, as measured by the cost of living index, rose by $8\frac{1}{2}$ per cent.

115. Measured over the period 1924 to April, 1931, the fall in the cost of living index has been 18 per cent., that in the wholesale index 38 per cent., and the rise in real wage rates about 20 per cent. The rates of wages do not, of course, take account of overtime, short time or unemployment; in addition, the wage-earners have throughout this period had the benefit of the increased social services and shortened hours. For those in employment Professor Bowley's index of earnings shows a fall of about 1 per cent. from December, 1924, to December, 1929, in comparison with a fall in the cost of living index of 8 per cent. in that period.

116. These figures are, however, averages, which conceal a wide diversity in the relative positions of workers in different industries and occupations. Although the average weekly rate of wages is

still some 70 per cent. above the 1914 level, the increase in many industries exposed to foreign competition is much below the average, and in some cases is substantially below the increase in the cost of living index. On the other side, this fall is, of course, balanced by a relative improvement in the wage rates of industries and occupations not directly exposed to foreign competition.

117. It would be misleading to infer from so brief a statement as we have given that the relative positions of wage-earners are to be judged by a comparison of rates at two points of time. Account must necessarily be taken of the state of adjustment of wages in different industries at the datum line. But such refinements are unnecessary for our purpose, which is merely that of forming a judgment on broad lines of the factors which may have impeded industrial recovery. With the absolute level of wages and with the question whether the standard of living which can be maintained on a given rate is a desirable or undesirable standard, we have nothing to do. But the very existence of the unemployment problem demonstrates that there is a disparity between prices and costs of production, which has the result of diminishing or eliminating profits and damping down all incentive to the expansion of output.

118. If Great Britain were a closed system, having no trading relations with the outside world, both diagnosis and remedy would be less difficult. For, provided that the disparity was not due to money wages and other costs rising faster than physical efficiency, it would presumably be the result of a failure of the purchasing power, paid out by entrepreneurs to meet their costs of production, to return to them in its entirety in the shape of the selling proceeds of their output. The right policy in these circumstances would therefore be for the banking system to stimulate investment by reducing the cost of borrowing, increasing the supply of purchasing power and discouraging the hoarding of balances.

119. But for a country which adheres to an international gold standard and in the economic life of which foreign trade plays a large part, a disequilibrium associated with unemployment may arise in any of three ways:—(i) it may be due to a domestic situation of the kind just described in which entrepreneurs as a whole are failing to receive back as sale proceeds the equivalent of what they have paid out as costs of production, (ii) it may be due to a situation of a similar character, but existing in the world as a whole, or (iii) it may be due to domestic costs having risen relatively to those of foreign competitors. Moreover, even if the trouble had arisen mainly under the first head, some of the remedies which would be appropriate in a closed system may be injudicious or impracticable, because of their tendency to cause excessive foreign lending, short or long.

120. The unemployment which existed at the time of our appointment was probably due, in the main, to the first and third factors. While we have been sitting, it is evident that the second factor has supervened in an aggravated degree, so that the present situation is highly complex. The remedy of the first factor still remains to some extent within our own control, but the difficulties and dangers of applying a remedy are much increased in an adverse international environment. To remedy the second factor, international co-operation is necessary.

121. On the question of the relative costs of production here and abroad we require to examine the position in some detail. An adverse change in our effective costs of production compared with those elsewhere might be due to any of the following causes :—

(i) Our technical efficiency of production might be declining, or increasing less rapidly, than that of our foreign competitors. It is extremely difficult to obtain a satisfactory statistical test of this. Doubtless our technical efficiency is not what it might be—but that is usually so; nor is a falling short of the highest a peculiarly British characteristic. It is true also that several of Great Britain's most important traditional industries are not amongst those which have been showing, of late years, the most rapid technical progress, and that we may have been somewhat slow, partly for reasons arising out of the War, in applying ourselves on an adequate scale to some of the newer industries.

On the whole, however, we incline to the view that the shortcomings of this country in technical efficiency as distinct from organisation may not have been so great or have played so large a part in producing our present difficulties as is sometimes supposed. This view is based on an examination of the relevant statistics relating to the year 1929; we take this year rather than 1930, partly because detailed statistics for 1930 are not yet available, but chiefly because for purposes of comparison with foreign countries the figures for 1930 are much confused by the effects of the world depression, an influence which has to be excluded for the purposes of the statistical test which we are trying to make.

In 1929 our exports of manufactured goods, though declining, were still greater than those of any other country in the world. At the same time our real wages, whilst comparing unfavourably with those in the United States (which country, however, is unable to compete with us in world markets in our principal staple exports such as coal or textiles and many iron and steel products) were much higher than those paid by any of our chief European

competitors, as shown in the following table (for January, 1930) based on hourly time-rates of wages :—

Great Britain	...	...	...	...	...	100
Holland	...	...	...	...	...	87
Germany	...	...	...	...	...	77
France	...	...	...	...	...	58
Italy	...	...	...	...	...	43

If we could retain so substantial an export trade in spite of so great a disparity of wage-rates, it would seem unlikely that our technical efficiency can have been much inferior to that of our competitors.

The figures for the increase in output per head per hour given in Appendix VI confirm this conclusion. Those figures suggest that hourly output per head in 1929 may have been quite 10 per cent. greater than in 1924 and 33 per cent. greater than in 1907. To take particular industries, the output per worker increased between 1924 and 1929 by 27 per cent. in the case of coal, 20 per cent. in iron and steel, and 15 per cent. in engineering and ship-building, though the extreme depression in the volume of sales caused a decline in textiles. Indeed, it could scarcely have been possible for British employers to have paid in 1929 real wages ten per cent. higher than in 1924 for hours 10 per cent. less than before the War, if they had not been making great technical progress, or if they had been falling seriously behind their competitors in technical efficiency.

122.—(ii) Access to our established markets may be made much more difficult by reason of increases of tariffs in those markets, or analogous measures, and our relative costs may require to be reduced if we are to be in the same position as before relative to competitors working under the protection of the tariffs. It is well known that this factor has played an important part, particularly in the case of textiles. Striking evidence of the increase of tariff rates will be found in Section IV of Statistical Tables relating to British and Foreign Trade and Industry (1924-1930) (Cmd. 3737).

123.—(iii) An adverse change in our position may take place owing to a change in the relative values of the national moneys in which the costs of production are paid without a corresponding change in the amounts of these costs expressed in terms of the national moneys.

It is here that we find the major part of the explanation of the adverse change in our costs of production compared with those elsewhere. The process of raising the gold-value of sterling, which culminated in the return to the gold standard at the pre-war parity, necessarily involved an increase in our costs of production in terms of gold unless these costs were being reduced *pari passu* in terms of sterling, which has not been the case.

Furthermore, the difficulties which this brought on our manufacturers were seriously aggravated by the fact that shortly afterwards several of our most serious competitors, in particular France, Belgium and Germany, suffered changes in the gold-value of their national moneys of precisely the opposite kind. That is to say, the rates at which they stabilised their currencies in terms of gold had the effect of decreasing their gold-costs of production, except in so far as these costs expressed in the national currency were tending to rise, which was only partially the case. It is difficult, or impossible, to obtain an exact statistical measurement of the competitive handicap which the relative over-valuation of sterling and under-valuation of certain other countries have imposed on our exporting manufacturers. But it is certainly substantial.

124. We must, therefore, attribute the difficulties of those of our industries which are either substantially dependent on exports or which are exposed to the competition of foreign imports largely to the fact that sterling costs did not prove adjustable to the change in the value of sterling necessary as a consequence of the return to gold at the pre-war parity; and still more so to the heavy fall in world prices which has since occurred.

125. This lack of adjustment has not, however, been a phenomenon working uniformly in all types of industry. The industries which have to sell their products at world prices in the face of foreign competition have in fact made substantial reductions in cost of production; indeed wage rates are low in comparison with other occupations. But the export industries require the services of transport and other occupations in which wage rates have been substantially improved as compared with the pre-war level and must therefore carry in their costs of production some part of the increase in the more sheltered industries. In these circumstances the export industries are driven, if they are to be successful in competition, to force their own costs yet lower in so far as the position is not met by increased efficiency in the transport and other occupations above mentioned. At the same time the cost of living is in part held high in relation to wholesale prices by the very fact that costs in the home services have been maintained, and the burden on the wage-earner in the export industries is thus intensified.

CHAPTER VI. — THE DISEQUILIBRIUM BETWEEN DEMAND AND SUPPLY.

126. The difficulties of this country which we have surveyed in the preceding Chapter have been added to by the course of events in the world at large. The period since 1925 has been at the same time one of rapid economic development and adjustment and one of great instability. Not only the monetary policies of other nations

but also the changes in the volume and the nature of production have had their reactions on this country. Pressure has come from many directions and in many forms. The total situation is complex, and we think it desirable, therefore, to review at some length such of the factors in it as are relevant to our conclusions on the monetary aspects of the problems presented.

127. If we survey the world as a whole, a distinction needs for some purposes to be drawn between Europe and other Continents. For though the disorganisation of currencies and the one-sided development of production in response to war demands extended beyond Europe, the weight of destruction, disorganisation and social and economic disintegration operated with special intensity in that Continent. Broadly speaking whilst the rest of the world progressed, in some areas with great intensity, throughout the whole of the period under survey—until the equilibrium of production was everywhere shattered by the international crisis through which we are still passing—in Europe, before absolute progress could be registered, a period of recovery had to take place. The first phase of recovery was completed by 1925. Up to that time, it was not suggested that currency reform and economic reconstruction stood in any sort of opposition to one another. Industrial recovery depended upon the restoration of order in the sphere of currency, for the instability of the currency was not only depriving the countries affected of the assistance of foreign capital, but was undermining the whole foundation of the social and economic structure.

128. The years which have elapsed since 1925, when Great Britain's return to the gold standard definitely ended the period of currency experimentation which had begun in 1914, fall into two sharply divergent phases; the first sub-period ending with the year 1928; the second commencing with the accentuated Wall Street boom of the spring and summer of 1929. In the first sub-period the circumstances and the technique employed in working the gold standard itself were on balance favourable to economic progress and to the re-establishment of the prestige of the standard. It is true that in Great Britain the return to gold was followed by industrial disputes in 1926, and, in consequence, by a marked decline in production for the time being. But the coal dispute and general stoppage, which might have been expected to produce serious difficulties in maintaining the international parity of the pound sterling, did not in fact lead to any such result, in consequence, no doubt, of the "flight from the franc" which preceded the *de facto* stabilisation of that currency at the end of the year 1926. In other respects the European situation during those years was improving. The Dawes Plan had put the Reparations question upon a reasonable basis in 1924, and the Dawes Loan had enabled the Reichsbank to accumulate the necessary funds for the rehabilitation of the German currency. The recession of German

business in 1926 was successfully overcome. The work of financial reconstruction undertaken by the League of Nations in Austria, Hungary, Greece and Bulgaria, the stabilisation of the franc, the lira and the belga, together with the settlement of the Reparations question and the more friendly political relations between France and Germany, created an atmosphere favourable to investment and economic enterprise. In the sphere of central banking also, conditions were propitious. Friendly understanding existed between the Central Banks of the United States, Germany and this country. It appeared not impossible then that these banks might, in conjunction with the Bank of France, inaugurate a new era of successful and intimate co-operation. Prices were indeed falling in the earlier part of this period, but not at such a rate as seriously to impair equilibrium at a time when rationalisation was beginning markedly to affect costs.

The Production of Raw Materials and Foodstuffs.

129. Inadequate and unsatisfactory as the statistical material may be, there can be no question that the tendency towards an increasing return from human effort and a growing command over the resources of nature persists and has persisted in recent years. Thus it appears from the data collected by the Economic Section of the League of Nations* that, in comparison with the position in 1913, the world's population had by 1925 increased by some 5 per cent., whilst the general index of production had risen by 18 per cent. Excluding cereals and other foodstuffs, the index of production had risen by no less than 25 per cent. In other words, the command over the sources of well-being—in so far as these are measured by the growth in the volume of materials available for working up into more finished forms—had increased, even by 1925, much faster than the population.

130. If comparisons are made, not between 1913 and 1925, but between 1913 and 1928, much the same impression is received, with the significant difference that by 1928 the position of Europe relatively to the rest of the world had greatly improved. Between 1913 and 1928, the population of the world increased by 10 per cent., the production of foodstuffs and raw materials together by 25 per cent. Foodstuffs taken alone had increased by 16 per cent., raw materials by no less than 40 per cent. Moreover, to quote from the League of Nations Memorandum, "The apparently very rapid and substantial progress achieved by Europe in the period given represented, until 1925, a recovery of lost ground. In that year, the European index on the base of 1913 stood at 103. The indices of all the other Continental groups were very substantially higher. . . ."

* The following figures (unless otherwise stated) are obtained from the *Preliminary Memorandum on Production and Trade* and the *Memorandum on Production and Trade 1923 to 1928/29*, issued by the Economic and Financial Section of the League of Nations.

In 1923 . . . all the indices except that for Europe, which stood at 85, were well above the pre-war level. The rising figures for these Continents, therefore, during the whole period 1923 to 1928 represent rather normal progress than recovery. . . . In Europe the rate of growth since 1923 has averaged some 5.8 per cent. per annum, while in the rest of the world it was only 2.4 per cent. According to the preliminary information available, this differentiation in the rate of progress continued during 1929. If the U.S.S.R. were excluded from Europe, the differences would be still greater.”*

The Growth of International Trade.

131. From the standpoint of international trade, the growth has not been quite so marked, whether as regards Europe or the world as a whole. If 1913 be taken as base, the quantum of international trade increased up to 1928 by some 24 per cent.; more rapidly, that is to say, than the growth in the volume of foodstuffs production; less rapidly, on the other hand, than the growth in the production of raw materials. Nevertheless, the rate of growth was more rapid than the growth of world population—24 per cent. against 10 per cent. As regards Europe alone, the population growth (including Russia) of eight per cent. contrasts with a rate of growth in the quantum of international trade of some seven per cent. The divergence in the movement of the index of production of materials and foodstuffs and of the quantum of foreign trade is natural. For with the growth of population in the raw material and foodstuffs producing countries, a larger proportion of the local produce is necessarily consumed locally; international trade does not consist merely in a transfer of foodstuffs and raw materials, but of an exchange of these goods for manufactured articles, and the terms of interchange have altered to the disadvantage of the raw material producing areas; lastly, international trade is greatly affected by the volume of capital issues, the quantum of which depends upon circumstances having little direct connection with the conditions affecting production. Taken all in all, however, the statistics so far adduced prove that the general conditions have been favourable to a growth of material welfare throughout the world.

The Growth of Production generally.

132. This favourable impression is strengthened if the indices of production which are now available for various countries are drawn into the picture. Production as a whole—still more production as represented by official indices which do not pretend to cover the entire area—is subject to the vicissitudes of cyclical and other influences and is therefore liable to unequal growth from year to year. A recent foreign survey of the ground shows the position as follows:—

* *Memorandum on Production, etc., 1923 to 1928-9*, pp. 16-17.

*Industrial Production in Various Countries.***Monthly Average 1929 = 100.*

Monthly Average	England	Germany	U.S.A.	France	Sweden	Austria	Poland
1925	—	81·8	88·2	77·4	78·5†	—	72·7
1926	—	77·6	90·8	90·3	80·7	76·4	71·3
1927	96·2	98·4	89·0	78·8	85·2	89·6	88·7
1928	94·3	98·3	93·3	91·0	81·5†	100·5	100·3
1929	100·0	100·0	100·0	100·0	100·0	100·0	100·0
1930 1st Quarter	99·2	92·4	87·4	103·0	110·3	87·5	84·8
„ 2nd „	92·2	89·4	87·4	103·1	99·3†	89·3	80·0
„ 3rd „	89·0	80·8	76·5	99·6	93·3	79·7	82·3

The general impression given by the statistics is one of fairly continuous improvement up to 1929, followed by sharp declines in 1930. The same impression is derived from an inspection of the figures given in a recent British official publication:—

Base Period.	U.K.	Canada.	U.S.A.	Germany.	France.
	1924=100	1919-24= 100	1923-25= 100	1928=100	1913=100
1924	100	116	95	69	108
1925	—	125	104	83	107
1926	—	146	108	79	124
1927	107	156	106	100	109
1928	106	173	111	100	127
1929	112	193	118	102	139
1930—1st Quarter	111	173	105	94	144
„ 2nd „	103	175	103	91	144
„ 3rd „	100	158	92	82	139

The Effects of Increased Production in relation to Demand.

133. It is not difficult to find an explanation of the forces which made for increased production during this period. In consequence of the situation during the War, when demand was great and labour scarce, the standardisation of industrial methods and the introduction of labour-saving machinery necessarily received a great impetus. At the same time, the advantages to be gained by an integration of works and the building up of horizontal and vertical combinations in industry were very substantial. These forces did not cease to operate after the War was over. In some

* *Deutschlands Wirtschaftliche Lage an der Jahreswende 1930/31*, published by the *Reichskreditgesellschaft*, Berlin, p. 3.

† Influenced by labour troubles.

‡ *Tables relating to British and Foreign Trade and Industry*. [Cmd. 3737], p. 375.

countries, as in the United States, the growth of new needs and wants made it easier in the industries supplying those wants to organise production upon an ever vaster scale, and thus to obtain the well-recognised economies of large-scale production. In other countries, such as Germany, the pressure of heavy international debt payments, and the consciousness that the productive machine had been allowed to fall behind, combined to stimulate a process of reorganisation. What prosperity and the demand for still greater well-being achieved in the one case was enforced in the other by the pressure of want and scarcity. Thus the many-sided movement known as rationalisation has exerted a steady influence, making towards a reduction of costs, in all industrial countries, though the impetus thereto differs from case to case.

134. Had the technical changes in question been confined to manufacturing industry, a situation similar to one which has before occurred in the world's history might have repeated itself. Industry might have been reducing its costs, whilst the cost per unit of agricultural output might have been rising, thus altering the terms of exchange in favour of the agricultural countries. The actual development has been very different. For agriculture also has become subject to the influence of the technical advances of recent years, with the result that the absolute volume of agricultural production has greatly expanded, without a corresponding rise in the cost of production. On the contrary, recent mechanical inventions have created a problem of surplus labour in the agricultural regions of the world, at a time when technical changes were tending to reduce the chances of employment in industry, and when simultaneously the substitution of artificial products (for example, of artificial silk for cotton) was narrowing the market for, at least, some agricultural products.

135. Technical changes and the partial substitution of artificial for natural products, combined with a relative decline in the growth of population, thus created a situation of some danger even before the depression of 1929-30 occurred. The danger presented was that of the relative over-production of certain kinds of foodstuffs and raw materials and of a consequent fall in the prices of those products below the general level of prices. Moreover, if the general price level is falling the situation of producers of articles in over-supply is much aggravated. Industry tends to be depressed generally, and the demand falls away much more rapidly, relatively to the supply forthcoming, than it would in times of stable or rising prices.

136. It is beyond doubt that the rapid increase of production of, e.g., wheat, rubber, coffee was a factor making for instability of economic conditions in the countries largely dependent for their prosperity upon these products, even before the general dislocation of the price level occurred. In such a state of over-

production of particular commodities the natural remedy is a restriction of the supply. The process by which the weaker producer is eliminated is necessarily one accompanied by much hardship and—especially if the article is largely produced by small cultivators or small units—it takes considerable time to produce its effects. Attempts to rationalise, not only the costs of production but the conditions of supply, whether by attempting to control the output, or the quantity allowed to come upon the market, in the effort to achieve a fair measure of price stability and a guarantee both of profit and permanent employment to the producing unit, are therefore perfectly understandable and cannot be condemned out of hand. In fact, a variety of stabilisation schemes have been adopted in recent years and have been applied, either in particular areas or over the whole of the world, to rubber, sugar, zinc, coffee, nitrate, copper, iron and steel, tin, wheat, cotton. The majority of these schemes designed to secure orderly conditions of production, marketing and price have in practice failed to achieve their object. It is beyond our province to investigate the causes of failure. We are concerned rather with the results, and from that aspect it is clear that such schemes, when they do come to grief, are themselves a further cause of price instability. Especially is this the case where the temporary success of the scheme evokes a further addition to the supply or where a substantial part of the current output has been held off from the market. For, as the Federal Farm Board of the U.S.A. remark in their First Report—“the accumulation of a substantial volume, the most of which necessarily must be in the visible supply, has a somewhat depressing effect upon prices. Announcement that such accumulation will not be sold is not sufficient to reassure buyers unless the quantity thus held renders difficult the purchase of supplies adequate to the demand. Even then the demand is curtailed or limited to immediate requirements, and forward buying in anticipation of future needs is lessened.”

137. The position of the raw material producing countries has thus been an extraordinarily difficult one. High prices during and immediately after the War stimulated production, and by increasing the national income and financial strength of the producing countries made it easy to obtain capital loans; and this situation encouraged the consumption of additional imports and a postponement of the pressure on the national economy of the interest payments on capital loans. The very increase in production helped to bring about lower prices, and these lower prices led to the adoption of various schemes to prevent prices from depreciating further. The partial or complete failure of these schemes forced prices still lower, and discouraged capital imports, thus increasing the pressure towards a forced sale of exports to meet external payments of interest and for other purposes.

Changes in the Rate of Growth of Demand.

138. If, in certain cases, the most conspicuous feature in the situation threatening a rupture of the economic equilibrium of supply and demand has been an over-stimulus to supply from changing conditions of technology and price, in others rupture has been produced by a definite falling off in the rate of growth of demand. In these latter cases, it has not been a positive increase in the volume produced so much as the existence of a permanent excess capacity to produce, relatively to the changing demand situation, which has caused depression and dislocation. A distinction should be drawn, in other words, between such a case as artificial silk, where temporary depression has been due to a great increase in world-demand leading to an even greater increase in world-supply, and the case, e.g., of coal, which has had to meet the competition of oil and water-power with the result that the coal industry has been depressed throughout the world. The coal industry and the cotton industry—to some extent the woollen industry also—are indeed the leading examples of industries in this class; for, although the older centres of the cotton industry have found their situation aggravated by an increase in manufacturing capacity in newer centres, it is clear, to quote from the Memorandum on Production issued by the League of Nations, that the “generality of the depression through which the cotton industry is passing can be judged by the figures showing the number of weeks of forty-eight hours during which the total number of spindles from which returns were received were stopped.” These figures, which relate to the half-years ending January 31 for the years 1926 to 1929 show a considerable degree of depression even before the onset of the crisis in 1929.* Or, as the same authority elsewhere points out, “During the last three years the amount of cotton consumed has been practically stationary. But this is due to the fact that during this period the takings of the Russian mills have steadily increased, and there has been a similar increase in the use of cotton in some of the minor producing countries . . . If these two users (i.e. Russian and minor producing countries) of cotton be ignored, it will be found that the consumption in the year ending July 31st, 1929, was lower in all the Continental groups (excepting South America, where the change was slight) than it was in the commercial year 1926-27.”†

The Effects of Tariffs, &c.

139. A further influence affecting the equilibrium of supply and demand throughout the post-war period has been the increase in the growth of restrictive policies in the shape of Tariffs and Subsidies, Import and Export Prohibitions, the exploitation of the administrative features of the tariff for protective purposes, and the

* See Table XXII in *Memorandum on Production, 1925—1928-9*. p. 56.

† *Ibid*, p. 54.

retention of the national market for local manufacturers by the exclusion of foreign firms from public works contracts. Moreover, the number of separate Customs areas has increased in consequence of the break-up of the old European Empires. One of the effects of these commercial policies consists in the tendency to increase surplus capacity. The break-up of Europe resulted in the old industrial organisation of countries like Austria-Hungary being parcelled out among the Succession States. If the spinning section of the cotton trade was mainly located in one State, and the weaving in another, efforts were directed in each, through the instrumentality of the State, to setting up a new weaving and spinning section respectively. The net effect was to increase the total world capacity beyond the point at which the total equipment could find employment. No doubt to some extent the commercial policies which permitted these developments merely anticipated the inevitable. The growing rationalisation of agriculture brings with it, for instance, the necessity of finding alternative methods of employment for the displaced agricultural population. But the attempt to solve the transfer problem so created by the unco-ordinated tariff activities of a large number of independent authorities may very well accentuate the transitional difficulties involved, by action which increases the duplication of productive capacity and the consequent wastage of capital.

CHAPTER VII.—GOLD AND ITS DISTRIBUTION.

140. The questions relating to the production and distribution of gold have recently been under consideration by a Delegation of the Financial Committee of the League of Nations which has already issued two interim reports.* In these circumstances we think it unnecessary to review these questions in the detail which might otherwise have been required.

141. With the departure of the majority of countries from the gold standard during the War, the distribution of the world's monetary stock of gold naturally underwent a vast change. In particular during the earlier years of the War gold flowed largely to the United States in exchange for the goods required by Europe. At a later date gold flowed to that country when instability of the currency in various European countries caused a flight of capital. Thus when the international gold standard was restored the European countries held only £741 millions, or 35 per cent. out of the then existing aggregate gold stock of £2,102 millions,

* First Interim Report, C. 375. M. 161, 1930, II; Second Interim Report, C. 75. M. 31., 1931, II.

in comparison with the £1,138 millions (or 63 per cent.) held in 1913 out of a total stock of £1,803 millions. On the other hand the North American holdings had risen from £429 millions in 1913 to £950 millions in 1925, or from 24 per cent. to 45 per cent. of the total stock.

142. The general return to the gold standard created an intensified demand for gold, especially in European countries, for the reconstitution of Central Bank reserves as and when currencies were stabilised. For some time the demand did not become acute owing to the adoption in several cases of the gold exchange standard, but following the stabilisation of the franc, a large demand for gold arose from France. During the period 1925 to 1928 European gold stocks increased by about £165 millions or some £18 millions more than the total addition to world stocks in that period. At the same time the gold holdings of South America increased substantially, the loss falling in the main on North America. Since then the main feature has been the flow of gold from the debtor countries to the creditor countries, and, in particular, France and the United States, accompanied by even more severe reductions in the foreign assets of the debtor countries. Thus, the American gold stock rose from £880 millions to £944 millions between December, 1929, and December, 1930; the French gold stock rose from £336 millions to £431 millions during the same period. A continued growth in the aggregate gold stock has in fact been accompanied by a growing concentration in a few countries. It has been estimated that the world's monetary stock of gold rose during 1930 from £2,301 millions to £2,407 millions.* Of these amounts eight countries (Germany, Great Britain, France, Italy, Spain, United States, Argentina, and Japan), held 80 per cent. and 82 per cent. at the two periods. Of the amount controlled by those eight countries, the United States, France and Great Britain controlled 74 per cent. and 78 per cent. at the beginning and end of the period.

143. These changes both in the amount of the gold stock and in its distribution have given rise to much discussion. On the first point it is argued that the stock of monetary gold is being added to at a slower rate than that at which the physical output of the world's industry and trade is increasing and that this goes some way to explain the fall in prices which has already taken place and in any case threatens a fall in the future. On the second point, it is argued that whether or not there is an absolute shortage of gold, the distribution of gold has itself been such as to bring about a fall in the world price level.

* Selected Documents on the Distribution of Gold submitted to the Gold Delegation. C. 102. M. 38, 1931, II A.

The Output of and Demand for Gold.

144. So far as the absolute output of new gold is concerned the views of expert witnesses, both before our Committee and the Gold Delegation of the Financial Committee of the League of Nations, leave little room for doubt. The long-run tendency is for gold production to fall, though the rapidity of the decline in yearly output is differently assessed by different experts. Prospecting and mining for gold has now become a highly scientific and capitalised industry and as the world is more and more thoroughly surveyed the chances of discovering another field to take the place of the Transvaal, which now supplies about half the total world output, steadily diminish. Moreover, as Mr. Kitchin, whose own estimates are somewhat higher than the official estimates presented to the Geneva Committee,* stated in evidence before us, "If there is any important new discovery, it will (unless alluvial is concerned) reach appreciable figures only after many years' work. While it would not be reasonable to dismiss the possibility of considerable additions from new sources—the analogy of the history of gold itself and of other metals forbids that—it is not prudent to attempt to speculate on what is unknown and unassessable." (Statement, paragraph 18.)

145. Apart from new sources of supply, the possibility of a fuller exploitation of known supplies is afforded by future improvements in metallurgy and by the fact that a fall in mining cost—due to falling prices as distinct from additions to technical knowledge—leads to a more thorough utilisation of the gold-bearing ores. But, apart from the fact that an improvement in gold production through falling prices is analogous to curing one disease by inoculating a worse one, not very much reliance, we are given to understand, should be placed upon further improvements as an element in solving the problem. It must be concluded, therefore, that, so far as can be foreseen, the gold output of the world is likely to diminish. Mr. Kitchin, in fact, estimates that within a decade, the world's annual output of gold will have fallen from £83 millions to £76 millions. (Statement, paragraph 19.) A substantial part of this output is absorbed by industrial consumption and by hoarding in the East. Over the periods 1890-1914 and 1915-1929 it is estimated by Mr. Kitchin that about 42 per cent. of new production was required for these purposes. The Gold Delegation concluded on the available evidence that the non-monetary demand might amount to £37-41 millions a year.

146. There is no precise means of estimating the actual future needs of gold for monetary purposes. We reproduce in Appendix III an estimate of the monetary demand for the years 1930-1940 made by the Gold Delegation on alternative assumptions as

* The difference is not inappreciable, being of the order of six per cent. in the total production for 1930 to 1944.

to (a) the proportion of gold reserves to notes and sight liabilities maintained by Central Banks and (b) the annual rate of growth of world productivity. Apart from changes in existing currency regulations and practice, the Delegation concluded that the increment of new gold for monetary purposes would by 1934 fall short of the requirements of the price level assumed by the argument. The estimates of the Delegation took as their starting point the volume of the notes and sight deposits of Central Banks for the year 1928. Since that date there has of course taken place a heavy fall in world prices which, if it were to prove permanent, would be accompanied no doubt by a substantial reduction in the aggregate volume of notes and deposits. But this, as we have indicated, would represent an acceptance of the position rather than a remedy for it.

147. Whilst the available figures serve as a warning that, unless definite steps are taken to avoid the danger, a fall of prices due to insufficiency of gold will undoubtedly occur in the future, they by no means prove that the gold problem is one so closely linked with the physical facts of gold production as to make the outlook in any way a hopeless one. On the contrary it seems probable that, given good will and understanding on the part of the world's monetary authorities, the dangers threatening the price level can be postponed for a period of time sufficiently long to deprive the problem of practical importance.

148. In the first place, the maintenance of a stable price level is not bound up with an inevitable annual increment in the volume of the various forms of purchasing power held by the public—coin, notes and deposits in commercial banks. Changes in habits may alter substantially the amount of purchasing power which the public desire to hold in various forms and, as the world situation improves and confidence is restored, the holding of purchasing power in cash or liquid deposits may decline in importance. Thus even if a constant relation must be maintained between the growth of Central Banks' liabilities and the desire of the public to hold liquid resources, a rate of growth of the former less than that usually assumed as necessary will suffice. In the second place, the relation between total Central Bank liabilities and gold supplies is influenced by the form which those liabilities take. For in so far as the legislation governing Central Banks' reserve ratios requires a smaller (or no) reserve to be kept against deposit liabilities, a growth in these liabilities relative to total liabilities will diminish the pressure upon the available gold supplies. In the third place, it is not necessary that the volume of note issues should continue to be regulated, as it is now, by reference to the amount of gold held in reserve. If, as

we recommend in Part II of our Report, the principle is adopted that gold reserves should be held, not primarily against note issues, but to meet temporary deficiencies in the balance of international payments, there need be no obstacle to the creation of a much increased volume of purchasing power without any increase in the supply of monetary gold.

149. Some of the directions in which remedial measures might be found to avoid a future shortage in the supply of gold were indicated by the Gold Delegation as follows:—

(a) the concentration of all monetary gold in the reserves of Central Banks;

(b) the economising of these reserves by the reduction of the current legal minimum reserve ratios, full recognition being given to the varying requirements of different countries in accordance with their economic circumstances;

(c) a common understanding between Central Banks as to the reduction, as occasion demanded and circumstances permitted, of the proportion of total gold cover held in practice (i.e., the excess of cover over the legal minimum ratio).

150. These measures would all be helpful. We would only add to them the desirability of recognising the point which we have emphasised at the end of paragraph 148, namely, that there is no reason why the volume of purchasing power need be related in the rigid way which has characterised banking legislation hitherto with the volume of gold held in reserve.

The Distribution of Gold.

151. The present distribution of gold is very generally held to be unsatisfactory: a maldistribution to which is to be attributed a large measure of responsibility for the heavy fall in prices in recent years. It is necessary, however, to look beyond the statistical facts of the existing distribution and consider the causes which have brought that distribution about.

152. The fact that a substantial gold reserve is held by a Central Bank serves no doubt to create confidence in the credit structure of the country concerned. But now that, with small exceptions, gold coin has been withdrawn from circulation, an internal demand for gold cannot arise. The sole practical use of a gold reserve is to serve as a medium of meeting a deficit on the balance of international payments, until steps are taken to bring it again to equilibrium.

153. In the period since the return to gold the balance of international payments between gold standard countries has been affected by many circumstances of an abnormal character. The monetary policies adopted, the course of international trade, the erection of barriers against the free flow of commodities, and political instability have all played a part in contributing to the

movement of gold upon an unusual scale. Thus there has arisen in many countries a great stress on gold reserves. That pressure inevitably takes the form of a contraction of credit to prevent the undue depletion of gold reserves, with the result, if the strain is continued, of a diminution in business and investment activity and a fall in prices. It is to the instability of post-war international finance and especially to the irregularity of the flow of credit between debtor and creditor countries that the present distribution of gold and the pressure which the process of re-distribution has exerted on credit policies must be largely attributed. Amongst the causes of that instability the following are the most outstanding :—

(a) The burden of the War debts: the principal debtor, Germany, has until recently not been able to discharge her obligations by means of the delivery of goods but has been forced to adjust her situation by short and long borrowings from abroad.

(b) The entry of the United States into the group of the chief creditor countries has caused a dispersion of initiative and responsibility in the leadership of international finance.

(c) Many of the loans incurred since the War have been for non-productive purposes, having been of a political character or to balance budgets or to support the exchanges, or to build up currency reserves. Thus there have been many influences at work on the market rate of interest and on the movement of obligations in the international market which have had no close relation to the actual yield of new capital enterprise.

(d) The perils of the war and post-war period and the unfortunate currency experiences of many countries have led to a greatly increased preference for liquid assets as compared with long-term securities. Especially there has been a tendency on the part of many countries to pile up liquid claims in the leading financial centres, instead of embarking on foreign fixed investment or funded obligations. France, the third largest creditor country in the world, appears to have employed virtually the whole of her international surplus during the last three or four years in the purchase of gold and short-term liquid claims; whilst the attitude towards long-term foreign securities of the investors of the United States, which is now the second largest creditor country next after ourselves, has fluctuated violently. The effect on prices internationally of an increased preference for employing resources in the purchase of liquid claims, including gold, is the same as is that of hoarding in a primitive community. It is to this increased, and undue, preference for the employment of resources in a liquid form, rather than to the shortage of new supplies of gold, that the

fall of prices is to be attributed ; though of course it is the case that a suddenly increased rate of supply of new gold, if it could have occurred just at the right moment, would have increased the supply of liquid assets and would, therefore, have served to diminish the degree of tension set up and hence the fall of prices.

(e) Movements of gold have ceased of late to have what used to be considered their " normal " effect on the domestic credit policy of certain countries, notably France and the United States. In recent years it has been impossible to rely on action being taken by both the country losing gold and the country gaining gold to preserve international equilibrium, the one meeting the other half way, as we explain in paragraph 185.

154. We conclude that the important factor for consideration in the problem of the so-called maldistribution of gold lies in the removal or mitigation of the underlying causes which have led to the present concentration and we return to this aspect of the matter in our recommendations. Indeed, even a large increase in the current supplies of new gold would not do much good so long as the causes persist which have led to the present maldistribution of gold. For the additional supplies would soon find their way to the same destinations.

CHAPTER VIII.—THE SEQUENCE OF EVENTS SINCE 1925.

155. When in 1925 Great Britain took the decisive step of restoring the gold standard, the French, Belgian and Italian currencies were not yet stabilised ; in Germany the stability of the new currency had only been maintained by a drastic rationing of credit by the Central Bank in 1924 ; the future of Indian exchange was not yet determined ; and the Federal Reserve System had only recently developed in a deliberate manner its system of open market operations as an instrument of great flexibility in the control of credit conditions. The full implications of the technical changes taking place in industry were not by any means clear ; and, although in this country the volume of unemployment was already giving rise to grave concern, a general feeling was abroad that with the restoration of the gold standard and the settlement of the Reparations question the era of extreme instability had definitely passed away.

156. Outranging all these factors in ultimate importance, however, though influencing them and being in turn influenced by them.

was the development of the economic situation in the United States. For a century the United States had been borrowing heavily from Europe. America had freed herself from indebtedness to Europe during the War; and thereafter it appeared that the tide had definitely turned and that the United States, having undergone the transition from a largely agricultural to a predominantly manufacturing country was about to repeat the history of Great Britain and to emerge as an exporter of capital upon a vast scale. For some years after the end of the War, indeed, the growth of American capital exports was the indispensable means of recovery of economic conditions in the rest of the world. Issues of long-period securities in the United States reached their maximum in the four years 1925-1928, during which period the net amount offered on long period account aggregated \$4,789 millions, or nearly £1,000 millions—an amount twice as large as the volume of long-period capital issues (£482 millions) floated in London during the same period. At the same time, American concerns were also investing largely in foreign enterprises. Whilst the net amount advanced on long-term account by the United States was in reality somewhat less than these figures would seem to indicate, there can be no doubt either that American foreign investments assumed large proportions in these years or that they had striking effects upon the areas—Central and South America and Central Europe—where the investments were chiefly made.

157. To this movement many factors contributed—the desire of the great industries to safeguard their foreign markets; the sentimental attachment of American citizens of Central European origin to their original countries and the desire to aid them; the high rates of bond interest offered; the belief that the world was now once more politically and economically stable; the desire to assume a dominating role in Latin America; at times also (especially in 1927) a temporarily depressed condition of American business; a rate of per capita savings so large as to outstrip the possibilities of profitable investment at home in periods of business quiescence. But at a crucial moment one other factor intervened to accentuate the process. That factor was the policy of the Federal Reserve System in the second half of 1927.

158. Broadly speaking, the United States continued throughout the post-war period to gain gold, until by the middle of May, 1927, the gold stock of the U.S.A. reached its maximum figure of \$4,700 millions. It had been the avowed policy of the Federal Reserve Authorities to regard this gold stock as a trust fund, and therefore to prevent such an expansion of credit in the United States as would necessitate the permanent retention of the whole stock as a permanent reserve. The policy of gold sterilisation was the objective expression of this point of view. In 1927 the moment seemed to have arrived when the exigencies of the local credit situation coincided with the necessities of the outside world. In

the autumn of 1927 the Reserve System encouraged low money-rates in the New York market and thereby stimulated a boom in international securities. Gold flowed out, and by June, 1928, the United States had lost \$600 millions of gold, the gold stock on 23rd June, 1928, being \$4,099 millions against \$4,700 millions on 16th May, 1927.* The effect of these various incidents can be thus summed up. Easy credit conditions had more than restored the pre-war ratios between gold and the short-term liabilities of European Central Banks† and had, in conjunction with other circumstances, generated a period of world prosperity which, *inter alia*, enabled Great Britain to recover to some extent from the direct effects of the return to the gold standard and the industrial troubles which had followed upon it.

159. But the credit situation in the United States was now to change, and to change disastrously in its reactions upon the rest of the world. In the first place, cheap money in the United States strengthened the tendency, already present in spite of a relative ebb of business in 1927, to a rise in the price of common stocks. From 1925 to 1928 building and other construction in the United States was on an unprecedented scale, reaching the colossal aggregate of \$38,000,000,000‡ for the four years together (or about £160,000,000 a month), which was about double the value of the construction in the four years 1919 to 1922. The putting into circulation of this enormous volume of purchasing power, which was not directly associated with any corresponding increase in the production of immediately consumable goods, caused a huge growth of business profits, which culminated in 1928 and 1929. At the same time the market value of securities increased in an even greater proportion than profits, the process of the appreciation of securities being greatly assisted, apart altogether from the influence exerted by cheap money and business prosperity, by the belief that a "new era" had dawned in the United States due to mass production and rising money wages. The difficulty of determining what was a reasonable basis for capitalising the yield of securities made it possible for securities to sell at 30 to 40 years' purchase, or even more, without upsetting public opinion, and they did, in fact, sell at such values. With such glittering chances of stock appreciation before their eyes, it is not surprising that it began to be more and more difficult to float international loans in New York or to sell bonds to American investors, nor that the prices of already existing bond issues should decline. To the

* See Federal Reserve Bulletin, January, 1930—p. 2.

† Mr. Loveday's figures show that the ratio of Gold Reserves to notes and sight liabilities of Central Banks and demand deposits of commercial banks amounted (in Europe) to 14.0%, 13.2% and 15.2% respectively in 1913, 1927 and 1928. Memorandum on p. 103 of First Interim Report of the Gold Delegation of the Financial Committee of the League of Nations.

‡ Cf. "Planning and Control of Public Works" compiled by the National Bureau of Economic Research in New York.

bullish bond market of 1924-27 had succeeded the bullish stock market of 1928-29.

160. From the very beginning of the more spectacular stage of the boom the Federal Reserve Authorities watched the situation with misgiving. By three successive stages in 1928, the New York Reserve rate was raised from $3\frac{1}{2}$ per cent. to which figure it had been reduced in August, 1927, to 5 per cent. in July, 1928, and, at the same time, in an effort to get control of the market, securities held by the Reserve System were sold upon a large scale, whilst the volume of open market acceptances had fallen to a bare minimum of \$75 millions by July, 1929. These measures proved sufficient to prevent the demand for Reserve Bank credit from expanding by more than the amount required to offset gold movements but could not cope with other elements in the situation. As the Annual Report of the Federal Reserve Board for 1929 remarks, "The problem was to find suitable means by which the growing volume of security credit could be brought under orderly restraint without occasioning avoidable pressure on commercial credit and business. With the system portfolio of Government Securities practically exhausted by the sales made in the first half of the year 1928, the main reliance in a further firming of money conditions must have been further marking up of Federal reserve discount rates, unless some other expedient could be brought to bear in the situation."

161. The Reserve Board being unwilling to permit the Reserve Banks to raise the discount rate still further, the Reserve System tried to check the rising flood of speculation by moral suasion and by bringing pressure to bear upon the New York member banks, hoping thereby to cut off the supply of call-loan money to the Stock Exchange at the source. But though the supply of call-money from the New York Banks was successfully cut off, the total volume of call-money continued to rise. The effect was to raise the level of call rates to a figure which made investment in such funds highly attractive, and there was thus drawn into the vortex of American speculation a mass of short-money, not only from non-banking agencies in the United States, but from European countries as well, though as regards European funds the bulk came from deposits previously made in the United States. America exerted a double pull on the European monetary and financial situation. Capital was placed in American securities and contributed to their rise; the rise in price stimulated further speculation and demanded further amounts of call-money; the call rate rose and this, together with rises in other associated rates attracted further European money to the United States. But, more important, the rise of call-rates to highly attractive levels impeded investment by all those who thought the situation essentially unstable. By investing in call-money they kept their position liquid, and at the same time earned upon their funds at least as much as, if not more than, they would have obtained upon foreign investments, without any

risk at all. A further deterrent to foreign investment had thus arisen. The increase in the gold stock of the United States indicated the pressure on European and other money markets. Between June 23rd, 1928, and January 11th, 1929, the gold stock rose by 7 millions of dollars; between that date and October 25th, 1929, it increased by a further 282 millions. A general rise in European bank rates followed the gold drain to the United States, and was accompanied by a general stiffening up of open-market rates in the European money markets. Finally at the beginning of August, 1929, the New York bank rate was itself raised to six per cent. By that time the peak of production had already passed, and the business conditions which provided the justification for the boom were definitely at an end.

162. The effort to stop the boom in the United States, and the European attempt to resist the redistribution of gold, which followed upon the flow of funds to the United States, led everywhere to a policy of dear money, almost at the moment when economic conditions were becoming ripe for a policy of cheaper money. For the index of industrial production ceased to expand in the United States after June, 1929, when the Reserve Board's index reached a maximum (1923-25 = 100) of 126 (seasonal variations being eliminated). Moreover, by the middle of 1929 the construction boom in the United States had passed its peak.

163. Upon the influence of boom conditions and monetary policy in the United States on the working of the gold standard were superimposed the effects of French monetary policy. The stabilisation of the franc, though it had taken place at a rate much above the lowest to which the franc had fallen, had nevertheless left the French price level considerably below that of the outside world. Further, the period of stabilisation involved in France, as it had previously done in the case of Austria and Germany, a readjustment of the per capita holding of currency so as to bring the amount into line with normal needs. Thus, a stabilisation boom combined with an increased per capita demand for currency to swell the aggregate demand for francs which could only be supplied by the Bank of France. This shortage of currency was accentuated by the abnormally high figures of the French Treasury balances. The note circulation did in fact rise considerably. In 1927 the average yearly circulation had been 53.5 milliards. In the next three years the circulation rose (half-yearly averages) as follows:—59, 61.2, 63.1, 65.9, 70.4, and 73.8 milliards, the amount in the autumn of 1930 being affected by the discredit attaching to certain banking institutions, which led to a marked hoarding of currency. The importance of these developments from the standpoint of the international gold standard was that they involved an enormous inflow of gold into France.

164. These flows were rendered necessary primarily by the provisions of the law by which the Bank of France is governed. Preceding and during the period of *de facto* stabilisation a special Act had permitted the Bank of France to buy foreign exchange and to issue notes against such purchases. (Law of 7th August, 1926.) So long as the influx of French balances and the sale to the Bank of foreign assets could be carried out through a transfer of foreign exchange, no positive pressure was brought to bear on foreign money markets, though they continued to run the risk that gold might ultimately be taken. But the transition from *de facto* to *de jure* stabilisation was accomplished by means of a law (June, 1928) which did not incorporate any provision for making permanent the right to issue notes against foreign assets; on the contrary, the law of August, 1926, was repealed, and the resulting legal position of the Bank of France in regard to the purchase of foreign exchange has remained obscure. Moreover, the new law did not give the Bank power to buy even French Government securities in the open market, and thus to satisfy the demand for currency by purchases giving banks and holders of securities additional deposits at the Bank which they could take out in notes if they desired. The Bank of France was thus practically deprived of two important instruments of modern central banking technique—the right to issue currency not only against gold, but also against the equivalent of gold, and the right to increase the volume of credit and currency by operations in securities initiated by itself. These changes in the French situation coincided with that change in the American situation—the end of the period of cheap money in the United States—to which we have already referred. Currency was drawn in the first instance from the commercial banks leading to a reduction of their cash balances. In so far as the banks possessed assets, i.e., bills of exchange, which the Bank of France was prepared to rediscount, and to the extent that they were prepared to part with these bills, a replenishment of cash balances became possible. In so far as bills were not available, or, alternatively, to the extent that the banks did not desire to part with them, this method of meeting the situation failed. It was possible to satisfy the demand in another way, however. The banks could sell their foreign balances for francs, thus appreciating francs and bringing a flow of gold to France. The existence of these balances was due either to the original flight from the franc or to their replenishment owing to the failure to invest in the purchase of foreign securities the credit balance accruing to France on the current balance of indebtedness. Very great quantities of gold did, in fact, flow in. The net changes of the significant items are as follows:—*

* These figures are taken from a paper on French Monetary Policy read by Mr. R. G. Hawtrey before the Manchester Statistical Society in January, 1931.

*Changes between June 25th, 1928, and December 26th, 1930.**(Millions of francs.)*

Discounts and Advances	+6,467	Notes	+17,664
Gold	+24,643	Private Deposits	+5,954
Foreign Exchange	-382	Public Deposits	+5,611
	<hr/>		<hr/>
	+30,728		+29,229
	<hr/>		<hr/>

165. For a time, between June and December, 1928, the Bank allowed its foreign exchange holdings to increase to a total of 32,641 millions of francs. Thereupon up to May, 1929, exchange holdings fell by 6,132 millions and gold holdings increased by 4,485 millions and these changes must be presumed to reflect the deliberate intention of the Bank. But thereafter the Bank maintained a "passive" attitude—its holdings of foreign exchange hardly varied, but it allowed gold to reach it freely. Bank rate was indeed lowered to 3½ per cent. in February, 1928, and to 3 per cent. in the same month a year later. But this was a situation which a lower bank rate could do little to correct. Before the Wall Street crash something could have been done to stimulate foreign investment and thus to turn the tide of gold away from France. But the universal depression thereafter was not a propitious moment at which to begin, and of the 25 milliards of gold acquired in these thirty months, over 14½ milliards were acquired between September, 1929, and December, 1930, i.e. during the period of depression.

166. The burden of these gold movements was thrown upon two markets, London and New York, the position of which, of course, differed very much. Whilst in the calendar year 1929 gold exports from Great Britain to France amounted to £33 millions and in 1930 to £55.2 millions, the exports to France from the U.S.A. amounted during the same period to £28 millions—or less than one-half of those from this country. The period of heavy gold exports to France from America had taken place earlier; from May, 1927, to June, 1928, France had taken some £47 millions. Nor was the gold drain to France the only significant flow of gold from Great Britain—Germany took £18.4 millions in 1929 and £16.2 millions in 1930, whilst a heavy export of £7.9 millions took place to the United States in 1929. The pressure on the London money market is indicated by the average yearly stock of gold coin and bullion held by the Bank of England. This rose from £148.6 millions in 1926 to £150.1 millions in 1927, rose again to £162.6 millions in 1928, to fall sharply to £146.9 millions in 1929. And though in 1930 the average rose again to £155.1 millions, the explanation is only partly satisfactory since the gold inflow in that year was fed by "distress shipments" from Spain, Argentina,

Brazil and Australia which reflected the economic malaise of these areas. The pressure on the Bank is marked by the fact that, whilst in 1928 and 1929 of the bullion sold in the London market about one half was bought by the Bank, in 1930, of an amount of £43.91 millions sold, the Bank was able to buy only £1.41 millions.

167. The important issue from the standpoint of the working of the gold standard in this country is the reaction of Bank of England policy to the events we have outlined. Bank rate had been reduced to $4\frac{1}{2}$ per cent. in April, 1927, and remained unchanged till February, 1929, when it was raised to $5\frac{1}{2}$ per cent., the average gold stock having fallen from a maximum of £173 millions for the month of September, 1928, to £150.2 millions in February, 1929. Bank rate was not again raised until September 26th, 1929, when it went up another one per cent., the Bank having lost gold steadily after July, so that the average monthly figure for the gold stock stood at only £130.9 millions in October. If the figures of the Banking Department are studied for the two critical years under review, it will be found that the range of variation of the Bankers' Deposits was less than the variation in the Reserve. While there was some reduction in the volume of Bankers' Deposits, part of the fluctuations in the Reserve was offset by movements in the Securities, and this applies to an even greater extent to the quarterly movement than it does to the fluctuations over the two years taken in their entirety:—

	<i>Bankers' Deposits.</i>		<i>Reserve of Notes and Coin in Banking Department.</i>	
	(£ mills.)	Increase (+) or Decrease (—) (£ mills.)	(£ mills.)	Increase (+) or Decrease (—) (£ mills.)
1928 1st Quarter ...	66.9	—	41.2	—
2nd " ...	62.9	—4.0	47.5	+6.3
3rd " ...	68.6	+5.7	59.1	+11.6
4th " ...	64.5	—4.1	46.6	—12.5
1929 1st " ...	64.0	—0.5	54.3	+7.7
2nd " ...	62.1	—1.9	58.7	+4.4
3rd " ...	63.9	+1.8	35.4	—23.3
4th " ...	61.5	—2.4	32.8	—2.6
	—	—5.4	—	—8.4

168. In the critical third quarter of 1929, whilst the Reserve of the Banking Department fell by over £23 millions, the Bankers' Deposits actually increased by nearly £2 millions. The gold movements were thus not allowed to affect the basis of credit at that

time, though over the period as a whole the loss of gold was allowed to reduce the credit basis to some extent. Stated positively, Bank policy in so far as it made use of the weapons of open market policy and of bank rate consisted, it would appear, in preventing the *full* rigour of the international gold movements from affecting the volume of credit except in so far as it might be directly influenced by rising bank rates: and the rise in bank rates to a really deterrent level was long postponed.

169. But it must not be overlooked that, throughout the whole period since the return to the gold standard, the economic structure of this country has been exposed to quite exceptional strain, and that business opinion has been in consequence exceptionally sensitive to movements in bank rate, with the result that a level of bank rate not in itself highly deterrent to enterprise so far as its influence upon the profitableness of business is concerned may nevertheless have had psychological repercussions out of all proportion to the absolute magnitude in the movements of the rate. Moreover, in estimating the net influence of Bank of England policy in recent years, and especially before the American collapse in the autumn of 1929, allowance has to be made for the circumstance that the Bank has at times brought its influence to bear in a manner, which, as in the instances of unofficial embargoes on the flotation of new capital issues, is incapable of measurement in quantitative terms, but which, nevertheless, has exercised, at particular moments, a considerable influence upon the movements of business.

170. Since 1925, Bank of England policy has had to adjust itself to four major episodes: the return to gold itself, the inauguration of a cheap money policy in the United States in 1927, the stock-market boom, and the French gold drain in 1928-29. The view has been expressed that on occasion throughout these years, the Bank, by pursuing a less restrictive or more expansionist policy might have induced a similar policy elsewhere. But in the early days of the return to the gold standard a Central Bank inheriting a certain body of experience, and faced in any case with relatively difficult and novel problems would naturally hesitate before inaugurating a policy the success of which was doubtful and the failure of which would be attended with grave results. In fact, the Bank attempted at this early stage, so far as possible, to stabilise the volume of credit which it placed at the disposal of the banking system, whilst keeping the level of rates sufficiently above those in other centres to ensure the retention of foreign balances here.

171. During the period of cheap money in the United States, which lasted from August, 1927, to February, 1928, the Bank maintained its rate unchanged at $4\frac{1}{2}$ per cent., whilst its gold stock and Reserve in the Banking Department increased, accompanied by a decline in the Securities, deposits remaining substantially unchanged. In view of the fact that American monetary policy

was intended, *inter alia*, to relieve the European situation, it remains an open question whether the Bank might not, at that time, have pursued a somewhat more venturesome policy without running any overwhelming risks. In any case, by the end of 1928 the Bank had again lost a substantial part of the gold it had acquired in the second and third quarters of the year.

172. During 1929 the Central Banks of the world were faced by a combination of circumstances of a most abnormal character. In so far as that situation, reviewed in the light of history, induced drains of gold either of a temporary character (the American boom) or of a kind not amenable to the usual instrument of banking policy (the French inflow), requiring therefore a policy of acquiescence rather than of active opposition, it can be said that Bank of England policy was of the kind appropriate to the problems presented by the unfolding phenomena of the time.

173. If the events of the last five years are passed in review with the object of determining what lessons are to be drawn from them to serve as guides to future action and policy, it is necessary to distinguish between the incidents which are capable of recurrence, and those which may fairly be deemed to be of a purely passing and evanescent character, however disturbing they may have been at the moment of their actual occurrence. The world is not likely to have again to experience the simultaneous pressure on the monetary machine of an American stock exchange boom of such exceptional dimensions and a drain of gold for restocking purposes of quite extraordinary magnitude. This unique conjunction of events which gave to the years 1928-9 their peculiar impress is not likely to recur. After all allowances for these unusual or novel manifestations of the world order have been made, it is clear, nevertheless, that the working of the international gold standard requires, in the modern world, a realisation that the forces making for disequilibrium are very powerful and that any mechanical application of the purely empirical rules derived from pre-war experience could easily lead to very grave and unsuspected results.

174. Among the causes which may make for disequilibrium two stand out most prominently. In the first place, the working of the gold standard may from time to time be seriously affected by the recurrence of boom conditions in American economic and financial conditions. In the second place, the gold standard is liable to be affected by the breakdown, after a period of expansion, of the process of international investment. The immense growth of the financial and economic power of the United States has altered the scale, if not the terms, of the problem of American-European economic relations, and thrown upon the European Central Banks—in the absence of any definite guarantee that the Federal Reserve Banks will be permitted by public opinion to co-operate at all times whole-heartedly with other Central Banks—a task of great

difficulty, which can only be solved by common understanding and action. The vast technical changes now manifesting themselves in the sphere of agricultural production are only one among a number of features which give to the flow of international funds a new social and political significance. The working of the gold standard must be adjusted to these striking changes in world conditions, and the task of adjustment must be entrusted to the Central Banks.

CHAPTER IX.—THE COURSE OF INTERNATIONAL INVESTMENT.

I.—THE PROCESS OF INTERNATIONAL INVESTMENT.

175. The substantial variations in the volume of international investment in recent years and especially the abrupt reduction in the last two years, have contributed largely to the troubles which have overtaken both the raw material producing areas of the world, such as Australia and Latin America, and (to a smaller extent) those Central and East European countries which, in consequence of the war and of the post-war inflation, have become impoverished and unable to provide for themselves the capital of which they stand in need.

176. The supply of capital to overseas areas is for some countries an indispensable element in their development and, in so far as it is itself subject to irregularity, imports irregularity also into their economic life. For it is largely through capital movements that these overseas areas are linked up with the ebb and flow of economic activity in other, and particularly the capital exporting, countries of the world. The processes by which these fluctuations are transmitted are briefly:—

(a) The borrowing countries use a part of the capital borrowed for the purchase of constructional goods from the industrial countries, and the purchasing power thus circulated in the industries producing those goods provides at least some part of the market for the raw materials of the borrowing countries.

(b) In part the capital borrowed is used in the employment of labour in constructing railways or other plant, and is thus expended in the borrowing country itself. The borrowing country has acquired, through the loans granted to it, purchasing power in the lending country which it wants to employ locally. There is thus a demand for remittances from the lending country to the borrowing country and the exchange moves in favour of the borrowing country, which in these circumstances can either allow credit to expand at once or

import gold to form a basis for expansion. In either case the local demand increases and imports are stimulated. The increase in employment in the borrowing country caused by the expenditure of the loan moneys provides the means of absorbing these additional imports.

(c) Moreover, the adjustment of interest payments on capital previously borrowed frequently requires that there should be a steady stream of loan-moneys flowing towards these areas, so that the sums borrowed can be used to prevent a weakening of the exchange rate if, for any reason, it is impossible to meet interest payments by means of an export of local produce. Ultimately it is to be expected that interest on loans should be met out of the increased production made possible by the loans. If the increased production takes the form of exportable raw materials, the drafts drawn against the exports furnish the means of meeting the interest payments; if the increased production is in the form of general development (roads, etc.) the interest should be provided by taxation, which would reduce local spending power and thus diminish imports which would otherwise have been consumed locally. But this process of transfer works with great friction because of the fluctuating character of all raw material production and the lack of diversity in the production of raw material countries. A bad harvest, or series of bad harvests, plays havoc with the mechanism. In the absence of fresh capital loans, the flotation of which depends in the main upon world credit conditions, the gold or foreign exchange reserves of the local banking system must be used. If these sink to a point which engenders lack of confidence in the stability of the local currency, or if a fear that they will be exhausted causes a flight from the local currency, there may be no alternative except a departure for the time being from the gold standard.

177. The recent history of the South American Republics well illustrates the practical aspects of the matter. During the years 1924 to 1929 the United States and this country, respectively, made loans to South America approximating \$1,200,000,000 and £50,000,000. Take, for example, the small Republic of Colombia which received over those years \$170,000,000. There was a great boom. Competitive railway building and other public works sent up wages by leaps and bounds; imports vastly increased; food was imported where before it had been produced locally. When the golden stream ceased there was a collapse. Imports ceased and Colombia thus added its small quota to depression in the industrial countries. Prices fell precipitously and Colombia is only now recovering gradually from its previous excess.

178. This example can be multiplied in Brazil, Peru, Chile and even perhaps the Argentine, and certainly in Australia. The United

States made loans to South America on an undesirable scale; Great Britain with equally good intentions had already shown the way in the case of Australia.

179. The economic position of Germany again has been much influenced by the ebb and flow in the tide of international investment. Germany's working capital, much reduced by the war, was enormously diminished by the subsequent vast inflation. Her needs in this direction, her Reparations burden, and the necessity to build up a gold reserve, all compelled her to borrow very largely. In addition to large amounts of long-dated capital taken up by States, municipalities and industries, estimated in the Final Report of the Agent-General for Reparation Payments to amount to £335 million for the period 1925 to the end of April, 1930, German banks and other borrowers have taken up a very great amount of short-dated capital. In the period following the stabilisation of the mark, and especially during the boom in the American bond market, the imports of capital into Germany resulted in checking exports, in raising the standards of expenditure by the public authorities, and in encouraging a generally higher standard of life among the population. The dangers of over-borrowing were regarded so seriously by the authorities of the Reichsbank as to lead to an official control of capital loans raised abroad for purposes not regarded as increasing German productivity, and short-period loans, in particular, were regarded with disfavour. Nevertheless, the net movement of capital inwards was on such a scale as to affect profoundly the rhythm of German economic life; and the partial cessation of the flow, as well as the uncertainty whether capital could be borrowed or not, which has been the result of events in America and elsewhere since 1929, has had the result of profoundly modifying the economic, and through it, the political situation in Germany. It has become steadily clearer that Germany's heavy debtor position has placed her at the mercy of her creditors; if she cannot continue to borrow she must, by any reduction in costs necessary, increase her exports and reduce her imports, thus affecting the equilibrium of other countries trading with her and her customers.

180. It is unfortunate that, in practice, a cessation of loans to raw material producing countries generally coincides with a period of lower prices for their products, and, conversely, large capital imports accompany higher raw material prices. This tendency is the natural outcome of the preferences of investors, who are much more likely to lend to a country when it is prosperous and enjoying prices for its crops which are high relatively to the general level of prices. Thus the alternations of prosperity and depression are likely to be particularly severe in those countries, for the national

income is in the one case inflated both by large sales at high prices and by the effects of the expenditure of loan proceeds, and in the other case deflated by the absence of loan expenditure and by small sales at low prices. Nor do borrowing countries—at any rate the raw material producing areas—possess means which might help to stabilise their balance of payments in time of bad harvests. For they do not, as a rule, draw large payments for services—such as shipping, insurance and merchant transactions—but on the contrary have to pay for such transactions carried out on their behalf. Generally also their foreign investments are small.

181. In certain cases, moreover, particularly in the case of Germany, the cessation of foreign lending has been accompanied by an increase in the export of capital, short or long, by her own nationals, the combined effect of these two movements being, of course, greatly to accentuate the difficulties of the local situation. The causes of this double pressure are clear: a lack of confidence in the economic and political outlook of the area concerned deters foreign investment and encourages a flight from the local money market. In so far as the direct effect of a cessation of capital imports and of an increase of capital exports is to increase the strain on the foreign exchanges, the two movements work in the same direction and accentuate one another.

182. Statistics relating to the movements of international capital supplies are notoriously difficult to interpret. The volume of *new* capital issues (issues for conversion or redemption being excluded) throw no light upon the movements of private investments and may be in part or in whole offset by the movements inwards of short-term or long-term funds for investment purposes. Nevertheless, the figures for public flotations on the one hand, and the figure for the excess of credit over debit items in the balance of indebtedness, i.e., the net balance on income transactions, throw some light upon the fluctuations in the capital flow, although they may not be an accurate guide to the volume of capital investment.* The tendency of the British and the American figures is not to compensate each other, but to reinforce one another; rising together (so far as issues are concerned) sharply between 1925 and 1928, and falling in 1929. Thus, between 1928 and 1929, the net capital movements outwards from the United States fell by 561 million dollars, or £115 millions, while the total overseas issues on the London market declined from £143 millions to £94 millions, a total decline of £164 millions, a figure not far short of one-half of the absolute amount of New York and London combined in the year 1928.

* See Appendix IV.

II.—INTERNATIONAL INVESTMENT AND INTERNATIONAL DISEQUILIBRIUM.

183. Apart from new loans and purchases of securities in other countries, a creditor nation's claims on the rest of the world show, each year, a net surplus. A debtor country on the other hand, which requires and borrows money from other countries for capital development, possesses current claims on the rest of the world which are normally less than its liabilities. If, for the time being, it cannot borrow, it must try to meet the deficiency, so far as it can, by the export of gold. It is roughly true, therefore, that, if creditor nations do not lend their surplus, that surplus, so long as all parties remain on the gold standard, can only be employed in increasing the gold reserves of the creditor and diminishing the gold reserves of the debtor nations, with the ultimate result of the former finally having all the gold and the latter none.

184. Since no country, not even a young and developing one, can borrow incessantly and largely without incurring an external debt greater than it can stand, debtor countries which wish to be able to maintain their surplus gold holdings must not depart too far from a balance between debts to and claims on the rest of the world on income account, while creditor countries must, unless they are ready to upset the economic conditions, first of the debtor countries and then of themselves, be prepared to lend back their surplus instead of taking it in gold. In other words, all must perform their part towards maintaining a reasonable equilibrium.

185. Formerly, it was assumed that the efflux and influx of gold itself produced a new equilibrium by altering the level of prices in the lending and receiving countries respectively and thus modifying, through an alteration in exports and imports and through the short money market, the debtor position of the first and the creditor position of the second. Gold standard countries were indeed supposed to meet each other half way, each altering its conditions sufficiently to produce the desired equilibrium. This result might be soon reached in normal and quiet times between highly developed countries, able rapidly to adjust their short-money position and their balance of payments, and willing to let the increase or decrease of gold if need be freely modify their economic conditions. But in actual fact to-day the position of debtor countries is apt to deteriorate rather than improve as a result of their having to export gold. For it is usually beyond their power to adjust their balance of payments so rapidly and completely as to permit a complete cessation of borrowing; yet, in so far as they export gold, their credit as borrowers suffers. Thus, having lost their gold and not being able to borrow, they are forced off the gold standard. And creditor countries, on the other hand, when they have accumulated more than their fair share of gold, far beyond their legal require-

ments, fearing to provoke an inflation by letting the new gold produce a rise in prices, try, in effect, to make themselves insensitive to further imports. Thus, when equilibrium is profoundly upset between creditor and debtor nations, the whole world suffers. The adjustments to be made are greater than can be accomplished by a movement of short-money funds or by a small alteration in prices. The debtor countries suffer a serious deflationary crisis and some of them, probably failing to meet their problems by drastic measures, may be forced off the gold standard; the creditor countries will be affected both by the depression in the debtor countries and by the influx of large quantities of gold. Here is, perhaps, the major part of the immediate explanation of the collapse of international prices which we describe in the next Chapter.

CHAPTER X.—THE FALL OF INTERNATIONAL PRICES AND ITS CONSEQUENCES.

186. The general effect of the world depression upon the price level of commodities at wholesale cannot be more strikingly summed up than by saying that during the course of the year 1930, the Board of Trade index number (base 1924=100) fell by 17 per cent.; that the Economist index number fell between February, 1930, and February, 1931, from 84.2 to 66.5 (base 1927=100) or by over 21 per cent.; that some commodities suffered a fall of price within the year of between 40 and 50 per cent. and that, by February, 1931, all the main groups of commodities, with one exception, as measured by the Economist index number (1913=100), were below their pre-war price, as the following table shows:—

(Average 1913=100)

Date.	Cereals and Meat.	Other Foods.	Textiles.	Minerals.	Miscellaneous.	Complete Index.
Average 1924 ...	159.9	169.9	210.6	145.2	131.5	159.3
" 1928 ...	145.0	149.4	161.7	111.9	119.3	135.1
" 1929 ...	135.6	136.8	141.9	116.2	112.7	127.2
" 1930 ...	113.4	122.9	99.1	101.6	101.5	106.8
End Feb.: 1930 ...	119.5	132.2	115.1	110.1	108.4	115.9
" Jan.: 1931 ...	94.3	110.8	75.8	91.5	90.4	91.3
" Feb.: 1931 ...	92.9	108.4	78.0	93.5	90.5	91.6

Within the period February, 1930 - February, 1931, the group Cereals and Meat fell by 22 per cent., the group Other Foods by 18 per cent., Textiles by as much as 32 per cent., Minerals by 15 per cent., and Miscellaneous by 16½ per cent.

187. When wholesale price movements are compared with movements in the cost of living index and with index numbers of average weekly wages, it is at once apparent that the fall in the former has been much greater than the fall in the other series :—

(Base 1924 = 100 in all cases).

	Wholesale Prices (Board of Trade).		Cost of Living Index (M/L).	Index No. of Average Weekly Wages.	Industrial Production (Board of Trade).
	All articles.	Total non-food.			
1924 1st Quarter...	99.9	100.5	101	100	100
2nd " ...	98.5	100.3	97		
3rd " ...	99.3	99.1	99		
4th " ...	102.3	100.1	103		
1928 1st " ...	84.6	81.1	94	100.2	109.3
2nd " ...	86.1	81.4	94	100.0	103.6
3rd " ...	83.8	80.5	94	99.7	100.2
4th " ...	83.1	79.9	96	99.5	108.4
1929 1st " ...	83.6	80.5	93	99.5	110.6
2nd " ...	82.2	79.7	92	99.5	112.0
3rd " ...	82.1	79.3	94	99.3	110.7
4th " ...	80.7	78.1	95	99.0	114.0
1930 1st " ...	76.9	74.8	92	98.8	111.0
2nd " ...	73.4	71.5	88	98.3	103.1
3rd " ...	70.7	68.1	89	98.3	99.5
4th " ...	67.0	64.5	89	98.3	99.0
1931 1st " ...	64.0	62.2	85	98.0	95.4

188. The fall in the wholesale price index number is, of course, in no way a phenomenon confined to this country. Indeed, since the articles comprised within the scope of a wholesale index number are largely internationally-traded commodities, the rate of fall of their prices must be much the same in all countries, allowance being made for differences of qualities and tariffs and the movements of freight rates. We publish in Appendix V a set of wholesale index numbers for various countries from which it will be seen that between January and December, 1930, the price fall in Japan has been 20 per cent.; in Canada 19 per cent.; in the Netherlands 18 per cent.; in the United States and Italy 16 per cent.; in France approximately 14 per cent.; and in Germany 11 per cent.

189. The same feature of a much sharper fall in the wholesale level of prices than in the level of the cost of living, which is characteristic of the position in Great Britain, is to be noted in other countries. Thus the ratio $\frac{\text{Cost of Living Index}}{\text{Wholesale Index}}$ stood at 126 in January, 1930, and at 142 in December; in Germany, for the same months, at 115 and 120; in France (1st Quarter 1930, compared with last Quarter) at 101 and 120. Thus, all over the world

the wholesale price index has been falling abruptly and the cost of living has nowhere completely adjusted itself to the fall in the level of wholesale prices.

Consequences of the Fall in Prices.

190. The consequences which follow from a fall in prices of the severe dimensions recently experienced are complex and react with unequal incidence upon different types of income. They may be briefly summarised as follows :—

(i) All incomes fixed in terms of money, such as interest on the National Debt, debentures and other fixed-interest securities, remain unaltered. Thus incomes derived from those sources are able to purchase an increased proportion of the national output at the lower price level now prevailing. On the other hand, such incomes will, of course, lose this advantage if the fall of prices proves to be temporary, and meanwhile the rate of interest on all new lending should fall.

(ii) Many other incomes, which are not contractual in the same way as is interest on the National Debt, are fixed by custom or by statute. In the latter category fall, for instance, many classes of pensions and unemployment relief. Unless and until measures are taken by Parliament to alter these charges, the recipients benefit in the same way as do holders of contractual incomes.

(iii) The proportion of the national output which can be purchased by these classes of recipients being increased, the amount left for distribution between the remaining sections of the community is reduced, with the result that so long as salaries and wages are unchanged the final residue available for profits is inadequate.

(iv) The attempt to effect an adjustment sets in train a series of consequences making for acute trade depression and unemployment.

(v) In the sphere of international debts also a large fall of prices greatly increases the real burden falling upon the debtor nations.

191. It is apparent from this summary that a severe fall in prices upsets the entire balance of every kind of money settlement. It works to the advantage of those whose incomes are protected by contract or otherwise and to the disadvantage, either in the form of reduced incomes or of unemployment, of those who receive the residue of the national income. It brings with it the problem of reducing costs. For the entrepreneur, faced with a fall in the

price of his commodity and the money receipts he derives therefrom, must seek to reduce his money costs of production whether in the form of wages or otherwise.

192. Thus when prices fall the first person upon whom the impact falls is the business man (unless the fall is due to an increase in efficiency). Nothing occurs automatically to change his costs of production save in a minority of cases where wages are regulated by changes in the cost of living or by sliding scales based on selling prices, and even here, whatever reduction takes place necessarily lags behind the fall of prices in articles of international trade. The result is, in the first instance, a narrowing of the margin between prices and costs, that is to say, a diminution of profit. The burden of reducing costs is thrown on business men to effect as best they can.

193. Some part of their costs, e.g., rates and taxes and interest charges, it is not in their power to diminish. As regards the rest, their first effort, naturally, is to increase efficiency. But an important increase may not be possible unless they have been failing to do their best previously. Moreover, it will not help them competitively unless they can increase their own efficiency faster than their rivals are increasing theirs. Next they will, no doubt, cut out various items of expense which were never justifiable on strictly business principles, but were due to kind-heartedness, old custom, and for the sake of the amenities of life. If this is not enough, there are various further measures which they can take gradually in greater or less degree. They will cut out some of their marginal and least profitable lines of business, which are not essential to the maintenance of their connections and their organisation—which will already have the effect of somewhat reducing employment. They will resist rises of salaries and wages, which otherwise they would have been inclined to grant. They will endeavour to adjust the conditions of labour so as to make it cost less without earnings being reduced. And finally they may be compelled to join issue with their men to seek a general reduction of wages.

194. But the pace at which these things will happen will tend to vary widely from industry to industry. Where fixed overhead costs are a small proportion of total costs, the employer will be brought much sooner to the point where he has to choose between closing down or seeking to lower wages. Moreover, such cases will largely coincide with the cases where labour costs are a large proportion of the whole, so that there is little room for reducing total costs except by reducing labour costs. On the other hand, there are also many industries where fixed overhead costs are large, so that it will be worth the employer's while to accept much less than a normal contribution towards interest, replacement, etc., before financial considerations will impel him to close down. Such a situation will preclude expansion or even the replacement of old

plant as it wears out, so that it may spell a slow, long drawn-out ruin for the industry without the trouble being brought to a head by a sudden crisis. Between the extremes there are industries and firms at every intermediate position.

195. This procedure for adjusting incomes to upward changes in the value of money works well enough if the changes are gradual and if they are moderate relatively to the rate of technical progress. For the pressure put upon the business world by the declining margin between prices and costs will be limited in its effect to putting a brake for the time being on the rate of expansion and on the upward movement of incomes corresponding to the increased efficiency due to technical progress. It may even be beneficial by enforcing those necessary minor economies which get forgotten in a period of wide margins between prices and costs, and by regulating the relative rates of progress as between different industries. Moreover, the higgling of the labour market between employers and trade unions may be healthy and of a tendency to produce a proper equilibrium between the advantages offered by different industries, without threatening serious loss or serious hardship to anyone.

196. But if the change in the value of money is large and rapid the result is chaotic. Extreme hardship and injustice will prevail, and great loss to the income and wealth and productive power of the whole community. For the individual members of the community can be ranged in a long line, according to the degree in which their incomes are susceptible to pressure, beginning with those whose incomes are protected by contract, such as the recipients of interest on the national debt, through workers in sheltered industries protected by powerful unions, to workers in unsheltered industries, where labour is a large part of the cost, as in the case of coal. The process of bringing about a reduction of incomes will be protracted and unequal in its incidence, and years may pass before the injustices as between different sets of individuals will have worked themselves out.

197. Thus, although a severe fall in prices, if permanent, in itself necessitates a reduction of costs if business is to continue on a profitable basis, the process of effecting adjustment involves great friction. That it has not been made in this country we show elsewhere. The result is that business, being unprofitable, is depressed, output is reduced and unemployment results. We think that the recent increase in unemployment in every part of the world, accompanied by a decline in production, can in the main be attributed to the fall in the level of prices, unaccompanied by a proportionate reduction of money costs, however brought about.

The Relation of Falling Prices to Investment.

198. In the modern world, where a willingness to assume risk is an essential element of economic life, the process of investment is

seriously affected by the reduction of profits due to a disparity between prices and costs of production. An inevitable accompaniment of sharply falling profits is a decline in the yield of ordinary share capital, and therefore a fall in its market price, as has indeed taken place. Under these conditions it becomes increasingly difficult to finance new enterprise by the issue of ordinary shares. And yet in a period of falling prices it may in many cases be imprudent to finance enterprise by means of fixed interest-bearing securities, for the further prices fall, the more onerous the capital taken up on fixed terms of interest becomes. It has for two generations been a subject for discussion and dispute among economists as to whether periods of rising or periods of falling prices are more fruitful of technological improvement. The truth would appear to be that whilst periods of falling prices afford the greater inducement to cut costs, they do not necessarily afford the greater opportunity to do so, if the capital necessary can only be obtained on terms which will increase the aggregate risks which the entrepreneur must run.

199. The deterrent effect upon the process of introducing improvements due to the uncertainties of the future may, it can be argued, be offset by the greater margin of saving available from recipients of fixed incomes and by the fact that they are obliged, because of the rise in the value of fixed-interest securities, which commonly occurs in periods of falling prices, to accept a lower yield in the shape of interest. It is through these falling yields, indeed, that the burden resting upon the entrepreneur may be reduced, though very gradually. And with an increased willingness on the part of the public to invest their money in long-dated securities, these results will be obtained and may be an indispensable part of the process of recovery. But, so long as the economic outlook is very uncertain, and the public are disinclined to venture their savings, the additional savings possible to certain classes when prices fall (even if the aggregate for all classes were the same, which is more than doubtful) may merely be hoarded for the time being. If the public choose to hold their savings in liquid form, this may hinder the process of re-equipping industry or lowering the yield of securities; and, in so far as this is the case, the process of industrial and economic recovery is held up. The reluctance to venture savings is, in fact, a marked feature of the present depression and as potent a cause prolonging and deepening it as is the reluctance of the entrepreneur, depressed by his heavy losses, to seek new loans for new construction or the extension of his enterprise.

The Effects upon Public Finance.

200. In the direction of public finance also, a large fall in prices produces serious reactions affecting the equilibrium of the National Budget by its operation both on the revenue and on the expenditure

of the State. We need only summarise briefly the directions in which pressure is felt :

(i) The revenue of the State tends to be affected unfavourably in all its branches. Business depression reduces the volume of profits (including dividends distributed) liable to Income Tax and Surtax; the valuation of estates liable to Estate Duties; the volume of transactions liable to Stamp duties; the yield of Customs and Excise duties by reason not only of a reduction in the volume of goods consumed but of a fall in values. Consequently, in so far as the State must meet charges fixed in terms of money, it must meet the situation by an increase in the level, or an extension of the field, of taxation.

(ii) At the same time, the circumstances of the time tend to swell expenditure in certain directions with a view to relieving the unemployment situation or providing for the unemployed.

(iii) A high proportion of State expenditure is contractual in the form of debt interest and can only be reduced by conversions, either voluntary or on maturity, in favourable circumstances. A further large block of expenditure is fixed in terms of money by Acts of Parliament (e.g. Pension Allowances of many kinds, contributions to Health and Unemployment Funds and other Social Services) and is not readily alterable when changes take place in the value of money.

201. Examined from the point of view of the total tax burden, the position is that nominal Imperial taxation fell between 1920/1 and 1929/30 from £22 per head to £14.8 while the burden of local taxation remained unchanged at £3.9 per head. Thus total taxation fell from £25.9 to £18.7 per head. But the change in prices in that period has meant that the commodity value has risen from about £18 to £20 (expressed in 1924 values on the basis of the cost of living index); a reduction of nearly one-third in the nominal value of the taxation imposed has yet left an increase in the real tax burden.

202. Whilst it is difficult to form an estimate of the contractual elements involved in the Budget in the shape of pensions and social services, there seems to be little doubt that, including debt interest, some 60 per cent. to 70 per cent. of the total ordinary expenditure (excluding self-balancing items) is of this nature. Thus with a falling price level, while revenue falls, a very large proportion of expenditure is more or less fixed in terms of money. There are some favourable influences to be set on the other side, such as the lower cost of the Floating Debt and the possibility of large-scale conversion operations. Nevertheless, it would appear as if a most important consideration for those in charge of the public revenue to bear in mind, so long as the future course of prices is uncertain, is the avoidance of any form of obligation involving a large addition to the contractual obligations of the State.

203. The budgetary problems referred to in the foregoing paragraphs are not, of course, peculiar to this country. The fact that the fall of prices is a world-wide phenomenon has meant a general increase in the burden of indebtedness. But the problem is particularly acute in this country in that the recent fall of prices was not preceded, as was the case in many other countries, by a period of intense inflation followed by devaluation of the currency and, consequently, the destruction to a greater or smaller extent of the original debt burden. Relief from the weight of internal indebtedness was obtained in this way over a large part of Continental Europe; most markedly in Germany, Austria and Hungary, but to a great extent also in France, Belgium and Italy. On the other hand it must not be overlooked that Great Britain is still on balance a great creditor nation on long-term account, so that the fall in the price level has increased the commodity value of the whole of her external assets in the shape of sterling investments; whilst for Germany, as a debtor both on long-term and short-term account, the price fall has resulted in a serious addition to the burden of external indebtedness, both Government and industrial. And what is true of Germany is also true of those overseas countries which stand in the relation of debtors to this country. Indeed, as these areas produce commodities which have felt the price decline most heavily, their economic situation has deteriorated the more seriously; since their national income is more closely dependent on the sale of a relatively restricted number of commodities. Areas like Brazil, Argentina, Malaya and Australia, dependent upon sales of coffee, wheat and maize, tin and rubber, wool and hides and wheat, have felt the shock of falling prices the most. The result has been that their budgetary position has become very difficult; their exchange position no less so. The efforts to maintain faith with their creditors have imperilled the stability of their Governments, and this in its turn, has made it more difficult for them to raise fresh loans in the international capital market—loans which are vital to their further economic development and the realisation of their political stability.

204. In many respects it is the social rather than the directly economic consequences of falling prices which are most serious. For price changes raise delicate issues of equity between different classes of the community, the resolution of which presents grave difficulties. The payments received by the factors of production ultimately constitute income, and income is received by men and women with standards of social justice, with ideas of settled expectation and with a natural reluctance to make the necessary sacrifices. The tensions so set up are paralleled by the tension between creditor and debtor nations. Thus violent price changes (for what we have said applies *mutatis mutandis* to rising as well as to falling prices) initiate social as well as economic disturbances which leave no part of the national or international order unaffected. But we

feel that the significance of what has been taking place in recent months is not always fully grasped. A study of history would, we believe, confirm the opinion that it is in the changes in the level of prices, and in the consequential alteration in the position of debtors and creditors, entrepreneurs and workers, peasants and the tax gatherer, that the main secret of social trouble is to be found. Looked at from this point of view the events of the last decade are of the most extraordinary kind. A very violent depreciation of money was sufficient in the immediate post-war period to destroy over a large part of the continent of Europe all rational economic calculation and all orderly social and economic development. This violent movement was followed in turn by a period of relative stability in which material well-being progressed markedly. This phase has now been followed by a violent down-turn of prices the effects of which upon political and social stability have already been very great. The problems thus raised transcend in importance any others of our time and generation and we have regarded it as our main task to expound their significance and to bring forward suggestions for their solution.

CHAPTER XI.—THE INFLUENCE OF MONETARY POLICY ON THE PRICE LEVEL.

1. MONETARY AND NON-MONETARY FACTORS.

205. Many of our witnesses can be divided into two groups according to the way in which they answer the question whether the fall of prices is primarily due to monetary causes. But this difference of opinion may have appeared greater than it really is owing to a confusion as to just what is meant by the question.

206. Those who assert that the fall of prices is primarily due to monetary causes may mean by this that the fall is due to a failure of the monetary machine throughout the world to adjust itself to general economic perturbations. Those who deny the same proposition may mean that the changes and disturbances which are ultimately responsible for the fall of prices are non-monetary in origin and character. But there is nothing necessarily inconsistent between these two statements, and both of them may be true. Or it may be that those who emphasise monetary causes do so because they believe that the monetary machine *could* have adjusted itself to the non-monetary changes and so have avoided the fall of prices, if this machine had been operated with greater knowledge and wisdom, whilst those who emphasise non-monetary causes may do so because they believe

that it has not been within the power of the monetary machine to offset the effect of non-monetary changes on prices, so that the fall of prices could only have been avoided, if at all, by bringing to bear on the non-monetary factors. Here there is indeed a difference of opinion, but it is one, probably, of degree and of practical judgment as to what is or is not feasible.

207. Obviously the general price level must be governed by the volume of purchasing power directed to the buying of current output relative to the volume of this output. Moreover the behaviour of the world's banking and monetary systems as a whole must have a considerable influence on the volume of such purchasing power. To this extent, at least, the general price level is rightly described as a monetary phenomenon; and the controversy turns on the degree to which in practice a monetary system can exert its influence to remove difficulties due to changes in the rate at which such purchasing power circulates or in the uses to which it is put.

208. On the other hand, it seems to us equally clear that the economic difficulties of the post-war decade are primarily due, not to any wanton misbehaviour on the part of the monetary factors themselves, but to unusually large and rapid changes on the part of what are rightly described as non-monetary phenomena, these non-monetary factors again themselves producing monetary changes. In particular, war and post-war non-monetary causes led to the great and unwanted flow of gold to the United States from which such vital consequences have ensued. For example, in the foregoing summary of events we have attributed great importance (i) to the unusual instability in the demand for capital resulting from the losses and interruptions consequent on the War, (ii) to the changes in the established relationships between debtor and creditor countries consequent on the War debts, (iii) to the rapidity of technical changes in manufacture and agriculture, (iv) to the shifting character of demand resulting in a want of balance between the demand and supply of services as against manufactured products, of new types of manufacture as against old, and of manufacture as a whole as against agriculture, (v) to the rigidity of wage-rates, (vi) to the growth of tariffs, (vii) to the embarrassments of Budgets, and (viii) to violent changes in speculative activity in New York and elsewhere.

209. Our view is, therefore, that the price level is the outcome of interaction between monetary and non-monetary factors, and that the recent world-wide fall of prices is best described as a monetary phenomenon which has occurred as the result of the monetary system failing to solve successfully a problem of unprecedented difficulty and complexity set it by a conjunction of highly intractable non-monetary phenomena. Whether the inter-

national monetary system *could* have solved its problem is a matter on which we should hesitate to express a dogmatic opinion. It is probable that the difficulty of our national problem was much increased by the relative over-valuation of the pound sterling and under-valuation of many other currencies. But the satisfactory handling of the international problem, even if it was theoretically practicable, might have required a degree of knowledge, experience and prescience which no one in fact possessed or could have been expected to possess.

210. It will be sufficient for our purpose, in putting forward our recommendations in Part II of this Report, to hold that it should be our object to *increase* the power to exercise deliberate control over the price level; that there is nothing inherently impracticable in this; that with the gradual growth of knowledge and experience, and particularly with the further development of suitable machinery for regular international co-operation, the possibilities of such deliberate control should steadily increase; and that we should forward these ends to the best of our powers by being ready to attempt the task and to gain experience by practice.

2. THE TASK OF THE MONETARY SYSTEM.

211. The task of the monetary system, as we see it, is, therefore, to balance, so far as it can, by changes in the quantity and terms of credit, the effect on the price level of certain fluctuating factors, which, whether we prefer to call them or their underlying causes monetary or non-monetary, are largely outside the *direct* control of the monetary system. The fluctuating factors in question are, principally, the three following:—

(i) The proportion of bank credit which is employed for financial purposes as distinct from the purposes of new current output;

(ii) The degree of preference felt by investors for the employment of their funds in more liquid or in less liquid forms;

(iii) The readiness of enterprise to embark on expansion of one kind or another, given the financial terms on which the necessary resources can be raised.

The greater the amount of bank credit which is being used for financial purposes, the greater the desire of investors to keep their funds liquid and the greater the reluctance of enterprise to move forward on given terms, correspondingly greater—generally speaking—will have to be the volume of bank credit and the easier the terms on which the banking system is ready to lend, in order to keep the price level from falling; and *vice versa* when it is a case of preventing a rise.

212. It is no doubt less difficult to check a boom than to stimulate activity during a slump; but the checking of a boom may well prevent the subsequent depression from being as deep as it would have been if the boom had been allowed to proceed unchecked. In certain extreme states of speculative excitement or of depression and general want of confidence, it may indeed be well-nigh impossible for the banking system to exercise sufficient restraint or to provide sufficient stimulus. But such states of excessive excitement or depression are generally reached as a result of the excitement or the depression having been allowed to feed on itself; and it does not follow that the banking system could not have prevented the aberration if it had acted soon enough and drastically enough. The fact that a motor car is not well-adapted for getting itself out of a ditch once it has fallen in does not prove that it is beyond the powers of good driving to keep it in the middle of the road.

213. We pass, therefore, to a brief consideration of the means at the disposal of the banking system for performing its task. It would take us much too far into a difficult and intricate subject if we were to attempt a full analysis of the causes operating on the price level. But some account of the way in which we conceive of the monetary system as exerting its influence is a necessary introduction to the recommendations which follow in Part II.

3. THE FUNCTIONS OF BANK RATE.

214. The methods by which a modern Central Bank controls the volume and terms of credit in its domestic monetary system consist, in the main, (i) in what are now known as "open market operations," that is to say the purchase or sale of assets in the market on the initiative of the Central Bank itself, and (ii) in varying the terms on which it will purchase assets on the initiative of the seller, which is conveniently summed up as "bank rate policy." The effects of the two methods are different in detail and in the rapidity of their influence on the various elements in the market rather than in essence. It will be sufficient for the purposes of this section if we discuss the general consequences of the tightening or relaxation of the volume and terms of credit, as the result of deliberate policy on the part of the Central Bank, under the general designation of "bank rate policy."

215. "Dear money" (and *mutatis mutandis* "cheap money") produces a long chain of consequences, some of which result quickly and some only in the long run. The most important are, in the order of their normal time of occurrence, the following:—

- (i) Dear money tends to diminish the net amount which a country lends abroad or to increase the amount which it borrows. Both short-term lending and long-term lending are

affected, though it is the former which feels a change soonest and most sensitively. Thus there is an immediate favourable effect on the country's balance of international payments and hence on its foreign exchanges and its gold reserves. This assumes that the change in bank rate is a change relatively to rates elsewhere and is not merely keeping pace with changes elsewhere.

(ii) Dear money tends to curtail enterprise at home and the volume of purchasing power which is put into circulation. Some part of the purchasing power which is thus curtailed would have been spent on imports or on home-produced goods which are now released for export. Thus dear money has a favourable effect on a country's "visible" balance of trade; which, again, has a favourable effect on the country's balance of international payments and hence on its foreign exchanges and on its gold reserves.

(iii) The curtailment of enterprise at home has the secondary effect (by its influence on demand relative to supply) of making it impossible for producers who are still continuing operations to sell their output at as high a price as before. Owing to the various difficulties in the way of closing down, especially if the trouble is expected to be of short duration, and since even a reduced price will generally show some margin over prime cost, some producers will—for a time at least—accept a lower price for their products. This, again, will help the country's "visible" balance of trade.

(iv) The fall of prices considered under (iii) is a fall of prices which is not accompanied by a corresponding fall of costs and is, therefore, at the expense of the producer. If such a fall continues for any length of time it necessarily puts a pressure on producers to reduce costs, including wages if necessary. When costs as well as prices have fallen, the help to the country's "visible" balance of trade resulting from the fall of prices will be on a more durable and reliable basis.

216. Now it is not to be assumed on every occasion on which bank rate is raised that the whole of this train of consequences is desired or intended, or will in fact ensue. It depends on how deep-seated is the cause of the disequilibrium in the country's balance of international payments. But it is the peculiar property of bank rate policy that it exercises a pressure in the right direction whether the problem is merely one of momentary short-period adjustment or whether it is of a more fundamental character.

217. Thus the Bank of England has felt in the past, as we have been told in evidence, that it will be pursuing the safest course if it keeps its eye primarily on the movements of the foreign exchanges as the indicator of the balance of international payments,

and then effects its changes in bank rate mainly in response to such movements. For whether it be a passing trouble or whether it be an occasion for a more fundamental readjustment, this will be the right remedy.

218. There can be no doubt, in our judgment, that "bank rate policy" is an absolute necessity for the sound management of a monetary system, and that it is a most delicate and beautiful instrument for the purpose. Nevertheless there are certain limitations to its usefulness, unless it is supplemented in certain ways. In particular:—

(i) The business world has found it difficult hitherto to interpret the meaning of a change of bank rate in any particular instance. They may be uncertain whether it merely represents an effort to correct a temporary maladjustment in the international short-loan position or whether it is the beginning of a contraction which will produce a curtailment of enterprise and business losses until the necessary adjustments have been effected. Thus a change of no great significance which is likely to be merely temporary or seasonal may cause undue alarm and may have a seriously unfavourable psychological reaction on business confidence. The only remedy for this is to be found, we suggest, in a diffusion of knowledge as to the relevant facts and a readiness on the part of the Bank of England to inform the money market, and the joint stock banks, whenever it can, as to its views of the situation. If the public was enabled to distinguish changes in bank rate intended merely to equalise supplies of short-term funds between different international markets from changes made necessary by excessive costs or excessive activity at home and intended to cause a contraction of domestic credit, some unnecessary disturbances to confidence might be avoided, and in course of time industry would learn to be more philosophical about changes made for non-industrial reasons. We make certain proposals concerning this in Part II of our Report.

219.—(ii) A policy which waits upon movements of gold may be too tardy. For these movements are often the last event in a situation which has been developing for a considerable time. If we had a more complete knowledge, both scientific and statistical, of what is going on in our economic system, it might be possible to act sooner with great advantage, to correct aberrations before they have gone too far and thus keep business and enterprise on a more level keel. It would be better (if it is possible) to develop greater powers of diagnosis and not to depend so much on a comparatively late-appearing symptom. Such a policy would require definitely to be less automatic and would thus undoubtedly place greater responsibility on the banking authorities.

220.—(iii) Bank rate policy, guided and governed by the tendency of gold to move, is a means of maintaining the stability of the exchanges rather than the stability of business. It is a means of

keeping us in step with the rest of the world ; of keeping us, not at a steady pace, but at the same pace as others. Indeed so far from preserving a stability of prices, profits and employment, the maintenance of stable exchanges has the effect of transmitting to our credit system any serious disturbances, of a cyclical character or otherwise, which may be affecting the rest of the world.

All this, of course, is inherent in belonging to an international standard and is not the fault of bank rate policy which will merely be carrying out successfully the duty laid upon it. Nevertheless these considerations serve to emphasise the importance of two matters to which we shall refer in Part II of our Report, namely, the expediency of international co-operation with a view to keeping a steady pace for the international system as a whole, and the desirability of protecting our own national system so far as we can from being unduly sensitive to international perturbations of a temporary character.

221.—(iv) Bank rate policy is quite a proper instrument, not only for the correction of temporary disequilibrium in the international loan market, but also for regulating the pace of expansion and enterprise at home and for putting pressure on costs to accommodate themselves to changes in our relative situation or in the international price level. But it is only adequate by itself for such purposes within certain limits. When substantial changes in the level of our industrial costs are necessary to correspond to substantial changes in the value of money, changes in bank rate alone cannot hope to achieve all that is necessary. In such a case, however necessary it may be that bank rate policy should be employed to maintain the international value of our currency, some other supplementary means must be found to restore equilibrium. For consider how bank rate policy works out in such a case. Its efficacy depends in the first instance on reducing the profits of business men. When in the effort to minimise this result, output and employment are contracted, it depends on decreasing the amount of business profits and increasing unemployment up to whatever figure is necessary to cause business men either to decrease their costs by additional economies or to insist on, and their workers to accept, a reduction of wages. But public opinion does not easily acquiesce in such a process. And the reduction, if and when effected, will fall unequally and unfairly on those sections of the community who are least protected by contract, least able to defend themselves, and often least able to afford the sacrifice.

Moreover, those who are in charge of our monetary system will—naturally and excusably—be reluctant to carry through so ruthless a policy to its proper conclusion, with the result that we may continue for a long period in a depressed condition with severe losses and severe unemployment and yet with not enough of both to compel by *force majeure* the necessary readjustment of incomes.

Moreover once such a condition of depression has become firmly established a policy of dear money will no longer be necessary to ensure its continuance; for it will contain within itself the seeds of its own perpetuation.

4. THE SUPPLY OF CREDIT TO BUSINESS AND ENTERPRISE.

222. We have seen that, apart from its immediate influence on the international short-loan market, bank rate policy—and the same is true of "open market" policy—operates, as a method of currency management, by its effect on the terms and the quantity of credit which the banking system as a whole is in a position to afford to business and enterprise. For in making an adequately high bill rate effective in the market, the Bank of England varies the amount of its assets, and hence of its deposits, to the necessary extent, which, in turn, has the effect of changing on a much larger scale the quantity of credit made available by the joint stock banks, since, when the banks' deposits at the Bank of England are increased by a given amount, these banks feel themselves free to increase their own assets by nine or ten times this amount.

223. It has been explained to us in evidence that when the action of the Bank of England impels the joint stock banks to increase or decrease the volume of their assets (and hence of their deposits), the first effect of the change is likely to fall on the banks' more liquid assets, namely, their bills and their loans to the money market, and next on their investments; whilst, if they are forced to curtail their advances, they will first of all cut down advances of a financial or personal character and will be most reluctant to refuse advances to their customers for normal business purposes.

224. Thus the effect of credit expansion or contraction on the amount of business advances will be mainly indirect. The expansion or contraction of the amount of credit made available by the banking system in other directions will, through a variety of channels, affect the ease of embarking on new investment propositions. This, in turn, will affect the volume and profitableness of business, and hence react in due course on the amount of accommodation required by industry from the banking system. Finally the diminished (or increased) profitableness of business will diminish (or increase) the desire to embark on new investment propositions. Thus what started as an alteration in the *supply* of credit ends up in the guise of an alteration in the *demand* for credit.

225. It is for this reason that controversy is apt to arise as to the connection between business depression (or the opposite) and the policy of the banking system in decreasing (or increasing) the volume of credit. For example, it has been put to us, on the one

hand, that the maintenance of the basis of bank credit, and therefore its volume, at the actual figures of recent years instead of at some higher figure, however inevitable it may have been, has had an important influence in depressing British business and in causing unemployment. On the other hand, there has been a decided preponderance of evidence from banking quarters to the effect that sound borrowers for purposes of a kind which it is suitable to finance by means of bank loans have seldom or never been refused adequate accommodation by their bankers. Broadly speaking, the evidence which we have received from business quarters has also supported this view. But these two views are, for the reasons just given, not necessarily inconsistent with one another. For it is a usual characteristic of a process of restriction to reduce business profits below normal, just as it is a usual characteristic of an inflationary process to swell them above normal; and the reduction of profit naturally diminishes the eagerness of the business world to expand the scale of production or to seek bank advances on a larger scale. Indeed, anyone would expect that a restriction of credit, once it was well under way, would greatly diminish the pressure on the banks for new advances for the purposes of business expansion. Thus it would be a mistake to conclude from the absence of such pressure that a restriction of credit has, therefore, had no adverse influence on the volume of output and employment.

226. Since, then, it is a rare event for the banks—except, quite properly, at the height of an inflationary boom—to restrict the accommodation required by their business customers for liquid employment in their own businesses, the banks regarding this as having the first claim on their resources, it follows that the effect of a restriction of credit on business activity operates, as we have said above, in a different way. We think it would be generally accepted, as a brief summary of the case, that a restriction of the volume of credit has to be associated with a higher market rate of interest than would rule if the volume of credit were greater, that an enhanced rate of interest operates in a variety of ways as a deterrent to new capital enterprise and the volume of current business, that the reduction of new enterprise has an all-round adverse effect on the level of profits, that the reduction of profits has an adverse repercussion on the volume of output, and so on.

227. This train of events is partly brought about in a direct and obvious way; but partly also in a more obscure manner through its effect on the prices of long-term securities and on the ease and comfort of the new-issue market. Two examples will illustrate the character of what occurs. If, at a time when the public is showing an increased relative preference for liquid assets, the banking system—which is the main creator of liquid assets—does not increase the available volume of such assets in the shape

of bank deposits, it is inevitable that the price of non-liquid assets should fall; for the increased desire to hold liquid assets must either be satisfied by an increased supply of such assets or held in check by the loss which has to be incurred in exchanging non-liquid assets for liquid assets. In the second place, the banks are themselves large holders of investments, as distinct from bills and advances; and for the banks to keep the supply of advances for productive business equal to the demand for them does not serve to dispel the adverse effects of credit restriction, if it has to be done at the expense of the banks' investments.

228. We may now consider in the light of the above, the actual figures of the leading banks of England and Scotland for the six years from the beginning of 1924 to the end of 1929 (see Appendix I). During these years the banks did indeed increase the volume of their commercial bills and advances by the very large amount of £222,000,000. But £205,000,000 of this was found by the sale of investments and Treasury bills and the net increase in the banks' earning assets was only £70,000,000. Moreover this was occurring at a time when the public was showing an increased disposition to hold money on deposit account, fixed deposits increasing during the same period by £132,000,000. Except in so far as this increase in fixed deposits was offset by an increase in the assets of the banks, the tendency (by reducing the velocity of circulation) was in the same direction as that of a contraction of credit.

229. Or we may look at it in another way. According to the best evidence we can obtain, industrial output per head increased over the period covered by the above figures (1924-1929) by 10 per cent., whilst the numbers seeking employment in the insured industries increased by 7 per cent. Thus the potential output of the country may have increased by somewhere between 15 and 20 per cent. If at such a time it is found that the active deposits are substantially unchanged or slightly reduced, it is evident that deflationary forces have been at work though they have taken the form primarily, not of a reduction in the basis of credit, but in a lower velocity of circulation for bank deposits as a whole, due to a larger proportion of them having been held on fixed deposit account. Further, the effect of such forces on enterprise and employment is bound to be adverse so long as they last; an expectation with which the actual facts of the period from 1924 to 1929 are fully consistent.

230. We do not mean to imply by the above that it was within the power of the Bank of England to allow a larger basis of credit than it actually allowed. For it is arguable that, during the greater part of the period, the duty laid on the Bank by

Parliament to maintain the gold value of sterling at the figure to which it was restored in 1925 was incompatible with appreciably easier credit conditions than actually existed.

5. THE INFLUENCE OF THE BANKING SYSTEM ON INVESTMENT.

231. There can be no doubt as to the power of the banking system (subject to international limitations which we deal with below) to increase or decrease the volume of bank money. But what is not so certain is its power to control the volume of bank money which is actively employed. When it is a case of *contracting* the volume of bank money, the question is how drastic the contraction must be to produce an effect, rather than whether the banking system can achieve its purpose if it is sufficiently determined. For whilst a buoyant and optimistic market for investment and enterprise may contrive for a time to carry on the same volume of business with a diminished supply of credit, there are definite limitations to the possibilities of this. When, however, it is a case of expanding the volume of bank money with a view to stimulating active investment, the view is often expressed that the powers of the banking system may be altogether inadequate, since the additional bank money created may simply lie idle as an addition to liquid funds.

232. In discussing the power of the banking system to overcome this difficulty, we need to distinguish sharply between a more or less normal situation, and one of acute business depression at or near the bottom of a severe slump. In normal conditions we see no reason to doubt the capacity of the banking system to influence the volume of active investment by increasing the volume and reducing the cost of bank credit. For in ordinary circumstances the new-issue market is responsive to the ease of bank credit, and the additional real investment which ensues on a brisker new-issue market serves to increase profits generally and hence to stimulate enterprise in various directions. The effect of cheap and abundant credit on the willingness and ability of dealers and others to carry increased stocks, and hence to increase their orders to the manufacturer, is also important. Indeed it is more usual to emphasise the extreme ease of stimulating enterprise and investment in these ways, and hence the danger of inadvertent or excessive action, rather than the difficulty of providing by banking means a sufficient stimulus to produce a noticeable effect; and this view is obviously the right one.

233. Thus we consider that in any ordinary times the power of the banking system (subject of course as before to international limitations) to increase or diminish the active employment of money in enterprise and investment is indisputable; and it is equally indisputable that an increased activity of money in these

ways will tend to raise prices and that a decreased activity will tend to diminish them.

234. In the midst of an acute slump, however, a more difficult problem is presented. When conditions of extreme uncertainty and depression have developed, a mere change in the cost of short-term credit will not be sufficient by itself to attract borrowers for purposes of new enterprise who on other grounds are reluctant. Moreover, a limit is easily reached below which it is not practicable to reduce the cost of credit any further. An appreciable part of the charges made for loans by the joint stock banks represents, not pure interest, but their actual expenses in carrying on their business. Thus even if pure short-term interest, for transactions into which no element enters but pure interest, falls so low as to 1 per cent. per annum, the minimum rate which must be charged to the bulk of borrowers will nevertheless remain at an appreciably higher level than this. In fact the cost of short-term loans to most borrowers falls with the greatest difficulty below 4 per cent. Besides this fact, the extra inducement to borrowers of such a rate, compared with (say) 5 to 6 per cent., will not be very appreciable so long as prices are falling and profits small and precarious.

235. Some authorities have concluded from this that in such circumstances the monetary authority is largely impotent (although it does not follow that *earlier* action by the monetary authority might not have been efficacious) and cannot expect to promote a revival of confidence and of trade until its efforts are supplemented by some adventitious event bringing a stimulus from some other quarter.

236. As to the correctness or otherwise of this view, it is particularly difficult for us to dogmatise as there has not hitherto been any adequate opportunity for putting the opposite view to the test of experience. But we ourselves are inclined to the view that the monetary authority is not so powerless as is sometimes supposed and that the danger, if any, is rather in the direction of letting loose too strong a force, which it might be difficult to control later.

237. The preceding argument has dwelt, it will be noticed, on the cost of credit rather than on its quantity. What would be the result of the monetary authority largely increasing the quantity of bank credit in the circumstances supposed, whilst leaving the rate charged for loans to find its own level? For it will always be possible for the monetary authority to effect this by the purchase in the market of e.g., Government securities. It would seem safe to conclude that the price of Government securities would rise as a result both of the direct action of the Central Bank and also of the action of the rest of the banking system in endeavouring to find a use for the idle funds which the Central Bank would be thus placing at its disposal. A rise in the price of these securities must in due course be reflected to some extent in the price of other

securities of a less prime class. Conversion operations would be facilitated. And gradually the rise of price beginning with securities of the highest class will spread over wide classes of securities including most of those where the special risks of the slump are relatively unimportant. Moreover it may not need very drastic action on the part of the Central Bank to produce this result. For as soon as the course of prices for high-class securities has a markedly upward trend, it is likely that many persons who have hitherto preferred to keep their funds liquid will alter their preference in favour of securities.

238. So far, however, nothing will have happened except a rise in the market price of certain classes of fixed-interest securities. This in itself will not directly affect the prices of commodities or the volume of output and employment. But it will have affected by this time the cost of long-term borrowing by first-class borrowers; and there are, as a rule, various types of fixed investment such as house building and the expansion of public utility undertakings which are fairly sensitive to changes in the long-term rate of interest. There are many schemes, for example, which are not worth while at 5 per cent., but become profitable, on the best estimates which can be made, if long-term funds are obtainable at 4 per cent. Or again, a fall from 6 per cent. to $4\frac{1}{2}$ per cent. in the rate of interest on loans against houses is nearly as good as a fall of 25 per cent. in the cost of production, when it comes to calculating the minimum level of rent which will prove profitable; and there is reason to think that the demand for house-room is elastic.

When, therefore, this point has been reached, the effect of abundant credit on the long-term market will be to bring about an increase of actual new enterprise. The repercussions of this on business confidence and on the actual level of profits may then be expected to break the vicious circle.

239. It is not argued that this chain of events can be completed quickly. It may occupy a considerable time. The contention is that an increase in the basis of credit is a step which can be taken by the Central Bank in the supposed circumstances without any risk of untoward consequences—for at the worst the effect will be nugatory—whilst there is fair reason to expect that it may do something to set in train the course of events outlined above. Some of us take the view that, provided the policy was adopted by Central Banks generally, the most hopeful form of attack on the existing depression would be along these lines. The same method is one which could be, and ought to be, employed with great effect in the opposite circumstances, namely, in face of an incipient inflation. In such a case Central Banks should sell the securities which they had accumulated during the depression. Indeed they would have to be careful not to allow too large a basis of credit to

persist when once the vicious circle had been broken. The method proposed would in fact have the additional advantage that it would put the Central Banks in a stronger position for curbing the next tendency towards inflation, because they would have a larger volume of securities for open market operations.

6. INTERNATIONAL LIMITATIONS.

240. We have entirely neglected in the preceding section the limitations which are actually set to a policy on the lines considered by the duty of adhering to an international standard. It is evident that a Central Bank which belongs to an international system cannot afford to maintain credit conditions which are out of relation to those which obtain in the rest of the system. For otherwise the additional liquid funds made available in the domestic market will endeavour to find an outlet in foreign money markets where better terms are obtainable by lenders, with a resulting loss of gold.

241. It is necessary, therefore, in any policy, whether of expansion or contraction, which is adopted by a particular Central Bank that due attention should be paid to the relation of this policy to the policies which are being pursued by the other Central Banks. It is a condition of adherence to an international standard that a Central Bank must not get much out of step with the average movement of other Central Banks, under penalty of provoking large movements of gold. It is for this reason that we shall lay so much emphasis in what follows on the importance of international co-operation.

Part II.—Conclusions and Recommendations.

CHAPTER I.—THE MAIN OBJECTIVES OF THE MONETARY SYSTEM.

I.—THE GOLD STANDARD.

1. THE RECENT WORKING OF THE GOLD STANDARD.

242. Unfortunately, the anticipations of those who were responsible for our return to the gold standard in 1925 have to a large extent not been fulfilled. Whether these anticipations were justified at the time, and what other course was practically possible, are questions on which we do not all agree, but which it would be unfruitful now to discuss. The six years since that act of policy have, for the reasons stated below, proved to be of a very abnormal character and the sacrifices which a return to gold at the old parity involved have not been compensated by the advantages of international price stability which were anticipated.

243. The accomplished fact of the restoration of our currency to the pre-war gold parity and its maintenance there for a period of six years creates, however, an entirely new situation; and it by no means follows, even if the view be held, as it is by some of us, that a mistake was made in 1925, that the consequences can be repaired by a reversal of policy in 1931.

244. Apart from the more general considerations relating to the gold standard which we discuss below, there have been two sets of difficulties in the way of its working to advantage in recent years, one of which we may expect, and the other of which we may hope, to be temporary.

245. The first set of difficulties has been caused by the fact that the various gold-parities established by the countries returning to the gold standard did not bear by any means the same relation in each case to the existing levels of incomes and costs in terms of the national currency. For example, Great Britain established a gold-parity which meant that her existing level of sterling incomes and costs was relatively too high in terms of gold, so that, failing a downward adjustment, those of her industries which are subject to foreign competition were put at an artificial disadvantage. France and Belgium, on the other hand, somewhat later established a gold parity which, pending an upward adjustment of their wages and other costs in terms of francs, gave an artificial advantage to their export industries. Other countries provide examples of an intermediate character. Thus the distribution of foreign trade, which would correspond to the relative efficiencies of different countries for different purposes, has been seriously disturbed from the equilibrium position corresponding to the normal relations between their costs in terms of gold. This, however, has been a consequence of the manner in which the post-war world groped

its way back to gold, rather than of the permanent characteristics of the gold standard itself when once the equilibrium of relative costs has been re-established, though, even after six years, this is not yet the case.

246. The second set of difficulties has resulted from the international lending power of the creditor countries being re-distributed, favourably to two countries, France and the United States, which have used this power only spasmodically, and adversely to the country, Great Britain, which was formerly the leader in this field and has the most highly developed organisation for the purpose. This re-distribution of lending power has been largely due to the character of the final settlement of the War debts in which this country has acquiesced. For although Great Britain suffered during the War a diminution of her foreign assets of some hundreds of millions, she has agreed to a post-war settlement by which she has resigned her own net creditor claims, with the result, that on a balance of transactions, virtually the whole of the large annual sums due from Germany accrues to the credit of France and of the United States. This has naturally had the effect of greatly increasing the surplus of these two countries, both absolutely and relatively to the surplus of Great Britain. The diminution in Great Britain's international surplus, due to her war sacrifices remaining uncompensated by post-war advantages, has, however, been further aggravated recently by the adverse effect on her visible balance of trade of the first set of difficulties just mentioned, namely, the differing relationships between gold and domestic money-costs on which different countries returned to the gold standard.

247. This re-distribution of lending power need not, however, in itself have interfered with the working of the gold standard. The difficulties have arisen through the partial failure of the two recipients, during the last two or three years, to employ the receipts in the way in which Great Britain had always employed hers, namely, either in the purchase of additional imports or in making additional foreign loans on long-term. On the contrary, they have required payment of a large part of their annual surplus either in actual gold or in short-term liquid claims. This is a contingency which the normal working of the international gold standard does not contemplate and for which it does not provide.

248. But this set of difficulties, too, one may hope, though with less confidence, to be a temporary phenomenon. Should it not prove so, we can scarcely expect the international gold standard to survive in its present form. If for any reason, however plausible from its own point of view, a creditor country, after making all the purchases it desires, is unwilling to lend its remaining surplus to the rest of the world, there can be no solution except the ultimate

destruction of the export trade of the country in question through a relative reduction in the gold-costs of other countries. If there were no international standard, but each country had its own domestic currency subject to fluctuating exchanges, this solution would come about at once. For in this event the exchanges of France and the United States, for example, would by now have risen to so high a level relatively to the rest of the world that their exporters would have been driven out of business, so that their unlent surplus would have disappeared. According to the classical theory of the gold standard, the same result should ensue, though more slowly and painfully, as a result of movements of gold inflating costs in those countries and deflating costs elsewhere. But in the modern world, where, on the one hand, inflows of gold are liable to be sterilised and prevented from causing an expansion of credit, whilst on the other hand the deflation of credit set up elsewhere is prevented by social causes from transmitting its full effect to money-wages and other costs, it may be that the whole machine will crack before the reaction back to equilibrium has been brought about.

249. Unfortunately upon these two sets of abnormal difficulties there has supervened, starting in the United States, a business slump of a more normal type though of quite unusual dimensions, further aggravated, in the opinion of some, by being associated with the necessity for a transition from the high rates of interest appropriate to the War and post-war period back towards the lower rates which were typical before the War.

250. Naturally the total result leads some people to question the desirability of adhering to an international standard.

2. THE QUESTION OF AN INTERNATIONAL STANDARD.

251. This brings us to the question whether adherence to an international standard may involve the payment of too heavy a price in the shape of domestic instability. Many countries, both to-day and at former times, have found that such continued adherence involves a strain greater than they can bear. But these are generally debtor countries, the trade of which is concentrated on a narrow range of primary products subject to violent disturbances of prices. If we leave aside the position to-day, experience does not show that a creditor country with diversified trade is liable to suffer undue domestic strain merely as the result of adherence to an international standard. We are of opinion, therefore, that we should not be influenced merely by the exigencies of the moment, if there is reason to believe that there may be important counter-vailing advantages on a longer view. If we need emergency measures to relieve the immediate strain, we should seek them in some other direction.

252. In the particular case of Great Britain we believe that there are such advantages. One of our most valuable sources of income, indeed one of our most important export industries, is the practice of international banking and associated services. Along with our shipping and our staple export industries this has been for a long period past one of our main sources of wealth. It is by no means clear that the possible advantages to our export activities from the fact that a fluctuating exchange would automatically offset the rigidity of money-incomes would balance the unquestionable loss to the first named; and we might be a poorer country on balance. It is not necessary, in order to reach this conclusion, to exaggerate the benefits which accrue to us from our international financial business. They are not so enormous as to outweigh all other considerations. For example, it is not likely that they have gone even a fraction of the way towards compensating the losses of wealth through unemployment in recent years. It is not our case that industry should be sacrificed to finance. It is, rather, that the benefits to industry from a fluctuating exchange would be inadequate to compensate the losses in other directions. For whilst a fluctuating exchange would have undoubted advantages in certain conditions, it would often be merely substituting one form of instability for another. It would not be possible for a country so intricately concerned with the outside world as Great Britain is to escape so simply from the repercussions of instability elsewhere.

253. There is, moreover, a further reason which cannot easily be weighed merely in the balance of our own direct economic advantage and which weighs more heavily with us than any other. There is, perhaps, no more important object within the field of human technique than that the world as a whole should achieve a sound and scientific monetary system. But there can be little or no hope of progress at any early date for the monetary system of the world as a whole, except as the result of a process of evolution starting from the historic gold standard. If, therefore, this country were to cut adrift from the international system with the object of setting up a local standard with a sole regard to our domestic situation, we should be abandoning the larger problem—the solution of which is certainly necessary to a satisfactory solution of the purely domestic problem—just at the moment, maybe, when, if we were able to look a little further forward, the beginnings of general progress would be becoming visible.

254. We conclude, therefore, that we shall best serve the purpose for which we were set up, and have the greatest hope of securing a sufficient general agreement to lead to action, if we base our recommendations on the assumption, which we hold justified, that the next phase of monetary policy must consist of a wholehearted

attempt to make the existing international standard work more satisfactorily. It is possible—though we believe that hard experience will teach them otherwise—that some countries may be unable or may fail to work an international standard in a satisfactory way. But this is not yet proved, and it would be unwise for us, who have so much to gain by it, to give up the attempt to secure a sound international currency.

3. DEVALUATION.

255. It has been represented to us that, without in any way departing from the principle or the practice of adherence to an international standard, it is desirable for us in the national interest to do now what might have been accomplished with much less difficulty in 1925, namely, to revise the gold-parity of sterling. Such a step is urged on the ground that, if we diminished the gold equivalent of the £ sterling by 10 per cent. thereby reducing our gold-costs automatically by the same percentage, this would restore to our export industries and to the industries which compete with imported goods what they lost by the return to gold at a figure which was inappropriate to the then existing facts, and that it would also have the great advantage of affecting all sterling costs equally, whether or not they were protected by contract.

256. We have no hesitation in rejecting this course. It is no doubt true that an essential attribute of a sovereign state is a power at any time to alter the value of its currency for any reasons deemed to be in the national interest, and that legally, therefore, there is nothing to prevent the British Government and Parliament from taking such a step. The same may be said of a measure writing down all debts, including those owing by the State itself, by a prescribed percentage—an expedient which would in fact over a considerable field have precisely the same effect. But, while all things may be lawful, all things are not expedient, and in our opinion the devaluation by any Government of a currency standing at its par value suddenly and without notice (as must be the case to prevent foreign creditors removing their property) is emphatically one of those things which are not expedient. International trade, commerce and finance are based on confidence. One of the foundation stones on which that confidence reposes is the general belief that all countries will seek to maintain so far as lies in their power the value of their national currency as it has been fixed by law, and will only give legal recognition to its depreciation when that depreciation has already come about *de facto*. It has frequently been the case—we have numerous examples of recent years—that either through the misfortunes of war, or mistakes of policy, or

the collapse of prices, currencies have fallen so far below par that their restoration would involve either great social injustices or national efforts and sacrifices for which no adequate compensation can be expected. The view may be held that our own case in 1925 was of this character. The British currency had been depreciated for some years. It was obvious to the whole world that it was an open question whether its restoration to par was in the national interest and there is no doubt in our minds as to our absolute freedom at that time to fix it, if it suited us, at a lower par value corresponding to the then existing exchange. But it would be to adopt an entirely new principle, and one which would undoubtedly be an immense shock to the international financial world, if the Government of the greatest creditor nation were deliberately and by an act of positive policy to announce one morning that it had reduced by law the value of its currency from the par at which it was standing to some lower value.

257. Moreover, considering the matter from another point of view, in the environment of the present world slump the relief to be obtained from a 10 per cent. devaluation might prove to be disappointing. It is not certain that, with world demand at its present low ebb, such a measure would serve by itself to restore our export trades to their former position or to effect a radical cure of unemployment. On the contrary, in the atmosphere of crisis and distress which would inevitably surround such an extreme and sensational measure as the devaluation of sterling, we might well find that the state of affairs immediately ensuing on such an event would be worse than that which had preceded it.

4. THE PROSPECTS OF THE GOLD STANDARD.

258. The course of events in the last two years has had the effect of forcing a number of countries off the gold standard. But these are all debtor countries; and if matters continue as at present, it will be the debtor countries of the world, and not a creditor country such as Great Britain, which will be the first to find the strain unbearable. We consider that the leading creditor countries of the world should consult together to prevent matters from continuing as at present; and we deal at length with international co-operation in the next chapter. In order that Great Britain may speak with authority in such discussions, it is essential that her financial strength should be beyond criticism. This largely depends in the near future on an increase of her surplus available for new foreign lending.

259. In this connection it may be worth while to summarise the result of certain information which we have collected. For it is of

a reassuring character and goes some way to answer certain criticisms which have been made, or doubts which have been entertained, regarding one aspect of the financial position of this country. In view of the large volume of foreign issues which have been floated in recent years in London and of the common belief that, in addition, British investors have made large purchases in the United States, partly of foreign bonds initially issued in New York and partly of American securities, whilst at the same time our surplus for new foreign lending has been diminished, it has been surmised that Great Britain must have been financing some part of her new foreign investment on long-term by means of an increase, and perhaps a dangerous increase, in her short-term liabilities to foreign centres. We have accordingly made it our business to collect for the first time as full a summary as possible both of foreign liquid resources in London and of British acceptances on foreign account. We take this opportunity of thanking the Bank of England, which has done the detailed work on our behalf, and the numerous financial institutions which have willingly co-operated in supplying the information, since they have enabled us to fill what was perhaps the greatest gap in our previous knowledge of the financial commitments of this country. We cannot claim that our figures are complete and they could doubtless be improved with further experience; but we believe that they may cover, in quantity, nearly the whole field. The most important item about which we have no information is the total of sterling bills held in their own custody by foreign banks, and it may be that this item is a more fluctuating one than the items for which we have obtained figures. We were prepared to find that these totals might give some support to the fears expressed above, but in fact they are reassuring.

260. The figures are given in full in Appendix I (with some notes upon the items included therein) and may be summarised as follows:—

End of Year.	Deposits and Sterling Bills held in London on foreign account.*	Sterling Bills accepted on foreign account.	Net Liability of London.
	£	£	£
1927	419,000,000	140,000,000	279,000,000
1928	503,000,000	201,000,000	302,000,000
1929	451,000,000	176,000,000	275,000,000
1930	435,000,000	161,000,000	274,000,000
1931 (March)	407,000,000	153,000,000	254,000,000

* Exclusive of sterling bills held by foreign banks in their own custody.

261. We have not obtained figures prior to 1927. We think it probable that in the period between the return to the gold standard in 1925 and the end of 1927 London's net liability was increasing substantially, since the French balances abroad were mainly built up during that period. But these figures show that in the last three years so far from there having been a large increase in London's short-term liabilities, there has been a small decrease in their amount, so far as we have been able to ascertain it.† The preliminary figures which we have obtained for the first quarter of the present year indicate that this tendency has been continued.

262. We have not obtained figures of British balances abroad, i.e., of British short-term claims on foreign centres (which may be quite considerable in amount), or of various other items which would be required for a complete picture. It would be desirable to obtain these, as we recommend later in Chapter V.

263. It seems probable, therefore, that in spite of the reduction of our surplus, the whole of our *net* purchases of foreign securities have been paid for out of our currently accruing surplus on income account. It is possible, we think, that this surplus may be somewhat larger than the usual estimate.

264. As regards the immediate situation, it is also interesting to note that the trade returns, unsatisfactory though they are, bear

† It is interesting to compare these figures with the comparable items for the United States. (The American returns also include other figures reducing their total net liability, which we have not yet been able to collect for Great Britain.)

<i>End of Year.</i>	Deposits and Bills held in U.S.A. on foreign account.	Dollar Bills accepted on foreign account.	Net Liability of New York
	£	£	£
1927	637,000,000	83,000,000	554,000,000
1928	595,000,000	104,000,000	491,000,000
1929	632,000,000	171,000,000	461,000,000
1930	573,000,000	168,000,000	405,000,000

The figures of dollar acceptances are taken from the Annual Reports of the United States Department of Commerce on the Balance of International Payments of the United States and the New York Federal Reserve Bank Monthly Review. The figures issued by the American Acceptance Council are somewhat higher.

out the conclusion that the worst strain of a situation such as the present falls on the raw material countries. During the first quarter of this year the quantity of our exports fell off by more than 30 per cent., whereas the reduction in the quantity of our imports was only 6 per cent. Nevertheless, as a result of the catastrophic fall of raw material prices, the visible balance of trade has been actually less adverse to us than in recent years, the net position in terms of money moving £5 millions in our favour, so that less of our surplus under other heads (i.e., from foreign interest, shipping, etc.), is being required to-day to finance our imports than in 1930 or in 1929.

265. The same point can be strikingly illustrated by what has happened in the case of the single commodity wheat. At the price prevailing in December, 1930, the annual cost of our wheat imports would be about £30 millions less than it was in 1929, and £60 millions less than in 1925. It is obvious what a large contribution this single item represents to the national cost of supporting the present volume of unemployment. It is a great misfortune both for us and for the raw material countries that we should have a great volume of unemployment through their inability to purchase from us as a result of the fall in the price of their produce. But merely from the point of view of our balance of trade it is not to be overlooked that the latter fact not only balances the former but may even outweigh it. We conclude that the underlying financial facts are more favourable than had been supposed, and that Great Britain's position as a creditor country remains immensely strong.

II.—THE INTERNATIONAL PRICE LEVEL.

1. THE IMMEDIATE NECESSITY TO RAISE PRICES ABOVE THEIR PRESENT LEVEL.

266. We mean by the international price level in this context the composite price at wholesale of the principal foodstuffs and raw materials entering into international trade as measured by the best-known wholesale index numbers. We do not consider that a high degree of precision in the definition of this is necessary or practicable.

267. We are emphatically of the opinion that, even if a further fall of wholesale prices be avoided, their stabilisation at approximately the present level would be a serious disaster for all countries of the world alike; and that the avoidance of such an event should be a prime object of international statesmanship.

268. The losses which are now being incurred by nearly all categories of producers of average efficiency in nearly all countries

of the world are an overwhelming proof that the fall of commodity prices has gone far beyond the substantial reduction which might be justified in the case of many important commodities by the increases in productive efficiency which have been achieved in recent years. Consequently, even the continuance of the present price level—quite apart from a further fall—must prolong business losses and the unemployment which the attempt to avoid these losses necessarily brings with it, until a substantial downward readjustment of money-costs has been somehow brought about. This would mean a reduction of money-incomes except to the extent that efficiency can be increased yet further. But it is obvious that the reduction of money-incomes must encounter resistance. Each individual, whatever may be the ultimate effects upon his standard of life, resents the lowering of his salary or his wages by economic pressure, and cannot readily believe that this can be necessary at a time when the technique of production is making revolutionary strides forward. Governments and Central Banks will, justly or unjustly, be blamed for the misfortune. Social unrest will tend to make moderate and rational remedies more difficult the longer they are delayed.

269. The classes who have suffered by the fall are the shareholding class in general, the entrepreneurs and those thrown out of employment; they have suffered partly by a direct reduction in the national income, partly by the transfer of wealth from them to the rentier and the employed. If, on the other hand, an adjustment is brought about by a rise in prices, purchasing power will be transferred from the rentier and from those earning salaries and wages to the shareholder and entrepreneur in the shape of larger profits; though if, as a result of the adjustments, the national output is increased, the salaried and wage-earning class as a whole may easily gain more in increased employment than they lose in the purchasing power of their money earnings. The fact that an adjustment of all non-contractual incomes to the new level does not affect the rentier is of particular importance in Great Britain at the present time on account of the vast increase of national indebtedness contracted in terms of money as compared with Great Britain herself before the War and with most of her neighbours to-day who have by a depreciation of their currencies written down their war debts to a modest figure.

270. The increase in the burden of internal War debts ensuing on a rise in the value of gold money will present a most difficult problem if incomes generally become adjusted to the new lower level. But in addition to this, there is the intractable problem of international indebtedness. The internal obligations arising

out of the War contain to-day no provisions, such as were introduced into the Dawes Plan, for changes in the value of gold. Moreover, the fall in the prices of raw products is facing the debtor nations of the world, which are dependent on the sale of such products, with tasks of exceeding difficulty. Superficially the creditor countries may appear to obtain a corresponding advantage. But this may prove delusive. International credit is a fragile plant. The effect of the pressure of the present price level on the credit of debtor countries may, if it is long continued, prove so serious that their ability to contract new loans will be dangerously impaired. The vicious circle will then be complete. Creditor countries will find that the security of the loans which they have already made is evaporating. And the whole system of international loans, on which the trade and prosperity of the world and the development of its natural resources so largely depend, will be seriously affected.

271. Thus, a failure by the Central Banks of the world to attempt to redress the fall of prices, in our judgment, would endanger the principles on which modern economic society is founded, namely, the dependence of the productive process on the expectation of normal profit to individual concerns, and the sanctity of contract. For to allow prices to fall, whilst social forces maintain wage-costs, obliterates profit; and the attempt to reduce non-contractual incomes, without the power to abate contractual incomes immediately, jeopardises, both nationally and internationally, the sanctity of contract.

272. At the present time, the objective of raising the international price level would probably command widespread, though not universal, approval. When, however, it begins to rise again, a more widespread difference of opinion will soon emerge as to how far the recovery should be allowed to go. Beyond saying that a large rise towards the price level of 1928 is greatly to be desired, it is difficult for us at the present date to be very precise, because the exact answer will depend on the course of events in the meantime. To the extent that efficiency-earnings may have fallen in terms of money during the continuance of the slump, the first of our reasons, namely, the difficulty of effecting a change in the level of incomes will have spent its force. But the force of the second reason, namely, of the burden of indebtedness, will not have been weakened to an equal degree. Moreover, a point may come when the encouragement of a further rise, though desirable in itself, may be difficult or impossible without running the risk of setting loose uncontrollable forces which will generate an undesired inflation carrying the price level much beyond the equilibrium point, with the prospect of an injurious reaction, equally

uncontrollable, at a subsequent stage. Thus the decision in detail will have to be left to the exercise of practical judgment at a later date.

273. Nevertheless, we think it much more likely that attempts may be made to stop the revival prematurely than to allow it to proceed too far. We believe that this would be a great mistake. It is often argued, and it may well be true, that the power of the banking system to hold a business expansion in check is greater than its power to revive business when depression has set in. If, however, we are over-prompt to check every expansion, yet hesitant in the face of every depression, the net result will be a steady lowering of the price level with all the attendant evils of such a prospect. As soon as business begins to lift its head again, we may be sure that austere voices will be raised declaring that there is an incipient inflation of credit present which must be scotched, when, in fact, the existing deflation of prices will not yet have been redressed. After so severe a depression as the present one, when we have to travel such a long way to reach the most expedient position of equilibrium, it will be most important, in our judgment, to be slow to accept such advice.

2. THE LONG-PERIOD STABILITY OF THE PRICE LEVEL.

274. Yet whether or not the ultimate price level will be as high as we might have wished having regard to all the social expediencies involved, a point will eventually come when, taking the world as a whole, international prices will have been restored to a level which is appropriate to the then existing levels of salaries and wages and to the burden of monetary indebtedness. When this point has been reached, monetary policy directed towards raising the price level further must, of course, cease, and there must be substituted for it a policy which has as its objective the stability of the international price level.

275. Thus our objective should be, so far as it lies within the power of this country to influence the international price level, first of all to raise prices a long way above the present level and then to maintain them at the level thus reached with as much stability as can be managed.

276. We recommend that this objective be accepted as the guiding aim of the monetary policy of this country. The acceptance of such an objective will represent in itself a great and notable change. For before the War scarcely anyone considered that the price level could or ought to be the care and preoccupation, far less a main objective of policy, on the part of the Bank of England or any other Central Bank.

III.—INTERNATIONAL CURRENCY MANAGEMENT.

277. We have concluded that a restoration of the international price level should be a prime object of international statesmanship. How far such a restoration of the international price level is in fact feasible is, however, a further question. We believe that the outcome is likely to depend in part on a complex conjunction of economic factors in the world at large of a kind which is not directly controllable at the centre. Nor can we give a confident answer to doubters in advance of an actual attempt to solve what is a practical problem. We can do no more than aim at this objective to the best of our powers and persevere with practical efforts along the lines to be suggested below, or in any other way which may commend itself.

278. At the same time we see no great reason to doubt the feasibility of attaining the objective of a higher price level in due course, provided that the Central Banks of the leading creditor countries will work together with this end in view. No one would doubt the ability of a closed monetary system to bring about a rise of prices; in fact it is only too easy. Thus the chief ground of hesitation is the difficulty of securing adequate co-operation among Central Banks, rather than any obstacle inherent in the nature of the problem. The subsequent maintenance of stability may prove more difficult but experience alone will supply a confident answer.

279. We have already investigated in the previous section the ways in which the banking system can expect to influence the price level. The question of the practical steps in the right direction which it is worth while to attempt at the present time we discuss in the next ensuing chapter.

IV.—DOMESTIC CURRENCY MANAGEMENT.

280.—(i) The monetary system of this country must be a Managed System.—It is not advisable, or indeed practicable, to regard our monetary system as an automatic system, grinding out the right result by the operation of natural forces aided by a few maxims of general application and some well-worn rules of thumb. The major objectives of a sound monetary policy—for example, the maintenance of the parity of the foreign exchanges without unnecessary disturbance to domestic business, the avoidance of the Credit Cycle, and the stability of the price level—cannot be attained except by the constant exercise of knowledge, judgment and authority, by individuals placed in a position of unchallengeable independence with great resources and every technical device at their disposition.

281.—(ii) The managing authority should be the Bank of England.—It is not necessary in this country, as it was in the United States before the War, to create a new organ for the centralised

control of the monetary system. For we have in the Bank of England an excellent instrument for the purpose; independent of political influences, yet functioning solely in the public interest; with long traditions and experience and clothed with vast prestige, yet not distrustful (as we have learnt in evidence) of evolutionary change or hesitant of new responsibilities; entrenched in the centre of the struggle for profit and with access to the arcana of the market, yet itself aloof and untinged by the motives of private gain.

We put forward later in Chapter III certain recommendations which affect the Bank of England. But these recommendations are directed to the strengthening of the Bank and to the augmenting of the forces at its disposal for the attainment of its proper objectives.

Nor do we consider that any of our recommendations are inconsistent with the general direction of change which the Bank of England has already laid down for itself, as compared with its methods and organisation in the decades before the War. We have received evidence of the Bank's willingness to adapt itself to the new conditions and problems with which it has found itself presented. It would not be a true picture to portray new and lively elements of contemporary thought and enterprise springing up elsewhere in the City but held down by the weight of the conservatism of the Bank of England.

282.—(iii) The endeavour of domestic management should be to promote the stability of output and of employment at a high level by influencing the regular flow of savings into investment at home and abroad so far as is compatible with the international situation.—The problem as to how this influence is best exercised is essentially a practical one. So far as short-term loans are concerned, the banks both are and ought to be the main source of supply; and it should lie, therefore, within the powers of the banking system to regulate their rate of flow without undue difficulty. But the main source of supply of funds for long-term investment must be, normally and properly, outside the banking system; so that the influence of the banking system on the volume of such investment must be mainly indirect.

Nevertheless, since fluctuations in the activity of long-term investment are just as likely to upset the even flow of savings into useful employment as fluctuations in the demand for short-term loans, it may be that the monetary authority will do well to concern itself more deliberately with this aspect of the market than it has done in the past.

In any case, the London machinery for the issue of long-term loans should be of such a character that the facilities for home borrowers are at least as well organised as those for foreign borrowers, so that the stream of savings is distributed appropriately

between home and foreign loans. It follows that the technique of that part of our financial system which is concerned with our function of international banking should be so adjusted as to lead it to interfere as little as possible with the maintenance of an appropriate supply of credit to meet the requirements of domestic trade and industry. We return to this matter in Chapter IV.

283. This completes our outline of the main objectives of our monetary system. If we have raised expectations that we shall be able to propose in our detailed recommendations a sure and certain means of attaining these objectives, we fear that such expectations will be disappointed.

284. There is nothing, we believe, intrinsically out of reach in any of these objectives; but this does not mean that they are easy or immediately practicable of achievement. In the first place, the most important of them depend on international agreement and collective action and cannot be reached by a single country, which belongs to an international system, acting alone. In the second place, they cannot be attained by Act of Parliament, but must result from the exercise of a skilled discretion of a somewhat novel character for the full use of which the necessary experience does not yet exist. For this reason we have reduced to the least possible the legislative changes which we propose. We have aimed, rather, at suggesting a framework within which the necessary discretion can be most successfully exercised. Indeed, we attach, in a sense, more importance to the deliberate and explicit adoption of the main objectives of the system as we have laid them down, than to our subsequent suggestions in matters of technical detail. For many of the latter do not very greatly modify or enlarge powers which already exist.

CHAPTER II.—PROPOSALS RELATING TO INTERNATIONAL MONETARY POLICY.

285. In our statement of objectives we have recommended :—

- (i) That this country should continue to adhere to the international gold standard at the existing parity;
- (ii) That we should use our influence to lower the international value of gold in terms of wholesale commodities; and
- (iii) That, after prices have been raised sufficiently, we should aim at maintaining a stability of prices at the higher level thus reached.

It is evident that the second and third objectives require international collaboration for their attainment, since any influence

which this country can exert on international prices must be, at the best, limited. We deal in the first part of this chapter mainly with proposals for attaining the third objective, which is of a permanent character, and in the second part with the second objective, which is concerned with the immediate situation to-day.

I.—PROPOSALS OF A PERMANENT CHARACTER.

1. MAIN OBJECTIVE OF CENTRAL BANKS TO MAINTAIN STABILITY.

286. The main objective of Central Banks acting in co-operation in the management of the international gold standard should be to maintain the stability of international prices both over long periods and over short periods—i.e., they should both keep the average steady over a period of years and avoid fluctuations round this average from year to year. Or alternatively—if this alternative were to receive superior support—they should prevent prices from falling to a greater extent than is justified by the increase in the efficiency of production. Stability over long periods is largely a question of the adequacy of the quantity of gold available for their reserves taken in conjunction with the proportionate volume of credit created on this basis; stability over short periods, or in other words the mitigation so far as possible of the Credit Cycle, is, we believe, largely a question of co-operative monetary management.

But while these objectives can be simply and shortly stated the difficulties in completely achieving them are great and manifold.

2. USE OF CENTRAL BANK RESERVES.

287. The first difficulty, but in our view not the greatest, is the question of the adequacy or inadequacy of the future supplies of gold to serve as a basis for the world's currency and credit systems. It is important, no doubt, not to overlook the possibility of a problem arising at some future time as the result of an excessive supply of gold and of an unwillingness on the part of Central Banks to offset an increase in their gold stocks to the degree which would be necessary to avoid a large upward movement of prices. But in order not to burden our argument with what would be in present circumstances a purely hypothetical discussion, we shall generally assume in what follows that the problem is one of preventing the inadequacy of the gold reserves of the Central Banks as a whole from unduly limiting their power to increase the volume of credit.

288. Without co-operative steps to put the Central Banks of the world in a position to counteract in case of need a possible shortage in the supply of gold, such a shortage might indeed prove a serious obstacle to future prosperity. But our belief is that such counteracting steps present little difficulty, if public opinion can be educated to regard the use of gold reserves in a reasonable

light. A fundamental step in the right direction was taken, in our view, when as a result of the War the actual use of gold coins in circulation was abandoned and the obligation was imposed on many Central Banks to convert their notes, no longer into gold coin, but into either gold bullion or foreign gold exchange at their option. Thus we may expect not only that all gold available for currency purposes will be employed henceforward in the reserves of a Central Bank as a basis for currency but that the Central Bank will be freed from the danger of an internal drain. Its primary duty indeed remains to maintain the value of its notes at par with gold, but it fulfils it, not by its obligation to change them into gold coin, but by freely shipping gold bullion or selling foreign gold balances to maintain the par value of its exchange. The sole use of a gold reserve to-day is, therefore, to enable a country to meet deficits in its international balance of payments, until the appropriate measures can be taken to bring it again to equilibrium. This being the case, it is paradoxical that, in the numerous cases where countries have since the War re-established or established for the first time the gold or gold exchange standard, the consequent legislation has almost always expressed the total reserves of gold or foreign gold exchange as a definite percentage of the Central Bank's notes outstanding (plus in several cases its sight liabilities). Such a basis has no meaning except in so far as the resulting size of the reserve represents by a coincidence the maximum probable export strain on the particular country in question in respect of a temporary disequilibrium in its balance of payments. It is quite clear, if we take for instance the United States and France, that this is not so in their cases and that their holdings of gold now far exceed any conceivable export strain to which they might be exposed. Moreover, the proportional gold reserve system forces an exceptionally drastic restriction of credit as soon as the reserve approaches the legal minimum and therefore impels Central Banks to keep their reserves well above the legal limit. For this reason alone, therefore, greater freedom for the Central Banks in the use of their reserves is very desirable.

289. Under this heading, we strongly agree, therefore, with the general purport of the recommendations of the Gold Delegation of the Financial Committee of the League of Nations in their Second Interim Report. We hope that the following principles will be adopted by Central Banks generally :—

- (i) All gold standard countries should agree that they will not allow gold to pass into active circulation, whether in the form of coins or of gold certificates;
- (ii) Central Banks should give collective consideration from time to time to the question whether it would be in the general interest that the legal requirements in force in different

countries as to gold reserves should be relaxed or tightened up, and should undertake to use their influence with their Governments to secure changes along the lines indicated, so far as is compatible with their domestic situations. At the present time it is probably desirable that the legal requirements as to the gold reserves of Central Banks should be relaxed;

(iii) Central Banks should be permitted by the laws of their respective countries to reckon balances with the Central Banks of other gold standard countries, or with the Bank for International Settlements, as the equivalent of gold for all the purposes of the law. This would be a merely optional and permissive provision and would not force the discretion of any Central Bank;

(iv) There is also a further principle of central banking of a somewhat different character which must be observed if Central Banks are to be in complete control of the situation, namely, that Central Banks must not be unduly limited in their power to expand their deposits otherwise than against a corresponding increase in their holdings of gold or the equivalent of gold. Such undue limitation may result if the class of assets which the Central Bank is entitled to hold is too narrowly prescribed by law. Similarly, it should lie within the power of a Central Bank to restrict the volume of its deposits otherwise than by decreasing its holdings of gold.

290. With these provisions it should, we think, be within the power of the Central Banks collectively for some time to come, if not indefinitely, to ensure that the available quantity of monetary gold would not operate as a limitation on the use of a wise discretion as to the volume of currency and bank credit to be created by the gold standard countries as a whole. Whether the gold factor would or would not operate in fact as a drag on the price level must, of course, depend on the way in which individual Central Banks were working the system, whether they were accumulating gold reserves greatly in excess of legal requirements, and on how far they were availing themselves of the power to hold part of their reserves as foreign balances. But this would be equally true whatever—within wide limits—might be the current supplies of gold. We hold, therefore, that the current and prospective supplies of new gold from the mines need not necessarily prevent the international gold standard from functioning successfully.

291. On the other hand, we think it very important that the above recommendations should be carried into effect. For otherwise, we fear—although, as we have explained, we do not regard the limited quantity of the supply of new gold as the main explanation of the present depression—that many Central Banks, being

anxious concerning the adequacy of their gold reserves, will be in constant danger of nipping off a revival of confidence, of causing a premature reaction in activity, and of ultimately dragging down prices or keeping them down below the level which we have indicated as desirable. Without these changes, as well as others to be mentioned below, the international gold standard will be capable of functioning to the disadvantage of the world as a whole and will lack that element of durability which is in itself an important requisite of a currency system.

3. POST-WAR CHANGES IN GOLD STANDARD.

292. But even if gold itself were eliminated as a cause of instability through being in scarce or excessive supply, and if Central Banks were to be given greater freedom than now in the use of their reserves, are we justified in supposing that comparative stability of international prices can be achieved by a wise and concerted policy on the part of the Central Banks? It has to be remembered that it is the essence of an international standard that it causes all countries adhering to it to become, so to speak, a single "magnetic field". Disturbances in one country are almost necessarily transmitted to the others, the severity of the disturbance being in proportion to the economic weight and strength of the country in which it originates. Therefore all gold standard countries, and particularly all important ones, are vitally interested in each other's stability. Particularly if any country in a dominating position pursues a course which may appear to suit its interests, but is inconsistent with the maintenance of stability in the rest of the world, much damage is done certainly to the latter and probably in the end to the former also.

293. Serious instability of price movements and interest rates is, moreover, a great obstacle to the smooth flow of capital from the creditor to the debtor countries, more being lent at times of great investment activity than the latter can properly use productively, and in the subsequent reaction the flow being completely stopped. It is not always the lending countries, however, who are at fault. It is by no means unusual for borrowing countries to borrow unwisely—in too great amounts and unproductively. Borrowing brings about an inflation of demand, rising prices, profits and all the usual appearances of prosperity. This leads the borrowing country to borrow more and the lending country to be willing to lend, until the real excessive burden on the former is revealed either by an internal reaction or by a cessation or diminution of lending, both leading to reversal of the former prosperity.

294. So great in the past ten years have been the reactions of disturbances in one country on conditions in another that, if we were to take this period as a fair criterion, it would be necessary to

conclude that the power of the Central Banks by their joint and several efforts to secure stability carried a very little way. The Federal Reserve System of the United States has endeavoured to keep that country on an even keel since the War and yet, even if we ignore the violent movements of the immediate post-war period, it has been unable to prevent one of the greatest oscillations of boom and collapse in history. Again the Bank of England has aimed for some years to bring about an equilibrium between this country's conditions and world conditions, but, while prices have fallen, costs have remained rigid and the desired equilibrium has not been attained. The Bank of France, restricted by legal enactments, was unable to prevent its vaults being filled with many millions of gold which it did not want.

295. Nevertheless the violent movements of the post-war period are no doubt exceptional and, while we cannot hope that they are yet at an end, we may reasonably look for a gradual improvement. As we have pointed out in paragraphs 245-6, the re-entry of a number of countries into the gold standard, some under the influence of deflation and others under the influence of inflation, produced anomalies which are not likely to appear in anything like so acute a form under the normal operation of the gold standard. If these anticipations are well founded, it may be asked whether the aim of Central Bank policy should not be to return to the more automatic working of the gold standard of pre-war days, when, as it is supposed, the Central Bank's discount rate was raised more or less as a matter of course when gold went out and lowered when gold came in. In fact, however, the automatic operation of the gold standard even then was more or less limited to the sphere of the Bank of England and was satisfactory in its results only because London was then by far the most powerful financial centre in the world, had "sight" claims on the rest of the world much greater than those of the world on her, and could thus by the operation of her bank rate almost immediately adjust her reserve position. Other countries had, therefore, in the main to adjust their conditions to hers. But post-war conditions are widely different. In the first place, New York has risen to be an exceedingly powerful monetary centre with as strong a pull on the gold resources of the world as London. In the second place, the liquid resources held by foreigners at both monetary centres are enormously greater than they were before the War (the aggregate amounts in London and New York alone are about £1,000,000,000), partly as a result of the French inflation and stabilisation, partly owing to widespread lack of confidence, and partly owing to the development of the gold exchange standard. Not only is the liability thus imposed on these centres great, but movements of gold may take place on a considerable scale which are due, not to any fundamental disequilibrium of prices or other deep-seated conditions, but merely to temporary causes for which a change

in bank rate may not be a suitable remedy. The gold exchange standard itself, whatever its merits in economising gold, has added considerably to the complexity of the gold standard system. In the third place, both the Federal Reserve Bank of New York and the Bank of England have developed very considerably the "open-market" system which has been found in certain respects extremely effective. It is in itself, however, the antithesis of an automatic system. Thus, we believe, all Central Banks are faced with the necessity of a greater "management" of their currency systems, involving inevitably greater responsibilities and also a more urgent need of co-operation.

4. OBSTACLES FACING CENTRAL BANKS.

296. In this task of management, the Central Banks are faced with three main classes of difficulties:—

- (i) Non-monetary causes of instability;
- (ii) Possible divergences between the interests of their own country and those of the world outside;
- (iii) Inadequate control over the monetary machine and its working.

297.—(i) We have already referred in this Report to many non-monetary causes of disturbance, such as political troubles, war debts, seasonal variations, over-production in some direction or other, changes in tariffs, the collapse of the silver exchange, large changes in fashion and in demand, embarrassments caused by budget deficits or over-borrowing by Governments, rigidity of internal economic conditions, and lack of confidence resulting from all these; such causes for instance as many of those with which the Commonwealth Bank of Australia or the Banco do Brasil has been faced. These are all conditions which must hamper and may nullify any effective control by a Central Bank.

298.—(ii) Probably the most important difficulty is the apparent, and sometimes the real, divergence between the immediate domestic interests of a particular country and those of the world as a whole. Whilst we should not deny the possibility of a real temporary divergence, we think that this would be the exception, not the rule, and that such apparent divergences of interest would generally prove to be illusory or avoidable if fully understood.

Take, for example, the position of France in 1930. It might have been supposed that France, largely free at that time from unemployment or other symptoms of industrial crisis, might have had interests divergent from most of the rest of the world, which was in the throes of an acute phase of the slump. It may indeed have been the case that an expansion of credit, such as was probably desirable elsewhere, was undesirable in France.

Nevertheless it was clearly in France's interest not to attract gold from abroad in excess of what the Bank of France really wanted. For the influx of gold was calculated to produce three sets of consequences detrimental to French interests:—

(a) It was likely to cause an unwanted expansion of credit within France;

(b) It was likely to injure the French export trade by lowering foreign prices relatively to French prices and contracting the volume of demand;

(c) It was likely to have a seriously disturbing effect on the stability of the existing settlements of war debts.

It follows, as M. Moret, the Governor of the Bank of France, has pointed out in his review of the year 1930, that there was no way to harmonise the interests of France and those of the rest of the world except by an increase in French foreign investment at long-term, corresponding to the increase in France's foreign favourable balance in excess of her desire for imports whether in the form of commodities or of gold. M. Moret declared that the solution could only be found by encouraging foreign loans by France at long-term, that this would be a good policy for France, and that the troubles in 1930 were due to reforms with this object in view having failed for a variety of reasons to be very effective. We think that this is the right explanation, so that there was no real divergence in this case between national and international interests.

More generally, when a situation occurs—as it well may—where the circumstances of a particular country make it desirable that there should be some temporary contraction of domestic credit at a time when there is no such necessity in the world at large, it is by no means inevitable that a disharmony of interest should arise. For in such a case the last thing desired by the country contracting credit is to attract short-term funds from abroad or to put pressure on the gold reserves of the rest of the world. An influx of gold, quite apart from any embarrassment it may cause to other Central Banks, would merely hamper and nullify the efforts of the Bank receiving the gold to control inflationary tendencies at home. Moreover, the influx of short-term foreign balances under the influence of a temporary attraction is, and should always be regarded as, the equivalent of a *negative* gold reserve and consequently as a potential source of future weakness. If this is recognised, there exists, we suggest, a way to avoid mutual embarrassment, namely, that the Central Bank which is contracting credit should offset the international effect of this by increasing its own foreign short-term assets. There would probably be a limit to the scale on which it would care to do this; but a moderate operation on these lines might be sufficient in normal circumstances, provided that steps had been

taken in good time. This assumes that the Central Bank in question would be in the possession of a sufficient volume of assets disposable in the domestic market to be able to reduce the aggregate volume of credit to a degree adequate to its purpose and at the same time to replace a part of its existing assets by foreign balances or bills. But in any case the possibility of its being able to control its domestic situation must depend on its possession of adequate "ammunition" for the contraction of credit on the requisite scale.

In the more normal case where a Central Bank is contracting domestic credit in order to bring its local conditions into line with international conditions and so avoid a prospective loss of gold, the particular difficulty with which we have been trying to deal would not, of course, arise.

299.—(iii) But, even if there need be no real divergence of interest, a Central Bank may not possess over its own monetary system a control adequate to prevent a wide departure from stability. As we have already explained (para. 71), the control of the Bank of England over the amount of bank money in London within the limitations of an international standard is remarkably complete. But this is not equally the case elsewhere. The control of the Federal Reserve authorities over the creation of bank money in the United States, or its equivalent in the shape of direct loans to the call-market, is not as automatic, with the result that the Federal Reserve system has great inflationary and also great deflationary possibilities. Nor has either the Bank of France or the Reichsbank a control equal to that of the Bank of England.

Moreover, even if a Central Bank can control the amount of bank money and credit, it cannot easily control their uses or determine the purposes to which they shall be put. For the use to which bank credit is put the Central Bank must rely very largely on the commercial banks and other financial institutions. Furthermore, if expansion or contraction of credit leading to rising or falling prices has once gathered momentum, the capacity of a Central Bank to check it, certainly to check the contraction, becomes much more difficult, and the same volume of credit in a period of great activity has an effect on the price level quite different from that which it has during a period of depression.

300. Added to all these problems is the question as to the degree of stability which should be aimed at. We have said that the ultimate aim should be stability of the international price level, meaning by this the composite price at wholesale of the principal food-stuffs and raw materials entering into international trade as measured by the best-known wholesale index numbers. Difficult problems will no doubt arise as to whether any particular fall in prices is due to a greater ease or efficiency of production and different views may be taken as to whether such changes should be

counteracted by monetary influences. The general price level, for instance, might fall because of a heavy fall in the price of one commodity, e.g., wheat or cotton. Are Central Banks to attempt to counteract this influence by a general rise in other prices? We do not think it necessary to give a dogmatic answer to such questions. What can emphatically be said is, that instability of prices is a serious evil, that monetary influences on prices are more controllable than any other, and that the Central Banks should therefore so control such monetary influences as to favour stability rather than instability.

5. CENTRAL BANK CONTROL OVER THE VOLUME AND TERMS OF BANK CREDIT.

301. The method by which the Central Banks must attempt to achieve their aim of maintaining stability of the international price level over long and short periods is through their control of the volume and terms of bank credit. It is when we approach the questions relating to the control of credit, the causes of the Credit or Trade Cycle, and the alternations of prosperity and depression, that we reach some of the most fundamental and difficult problems in economic theory and practice, on which there still exists among experts very considerable difference of opinion. With these we do not intend to deal at length. But this should not be taken to mean that we do not regard them as of the greatest importance. When practical bankers and business men can explain clearly the causes of the Trade Cycle, why prosperity is followed by depression, and depression by prosperity, and can find practical means to avoid the economic waste caused thereby, and when they can adjust more satisfactorily the powers of the modern world to consume and absorb wealth with its powers to produce wealth, they will have more justification than they now have in ignoring and treating as of little or no consequence economic research into these very difficult but vitally important problems. The practical man is satisfied to make profits when the sun shines, and to bear his losses when the bad times come, regarding these alternations more or less as laws of nature, when very often they are due to the working of the monetary machine and are to some extent at any rate under human control. But, if they are even partly under human control, it is of the utmost importance for the betterment of humanity and the stability of society that such methods of control as may exist should be worked out and put into practice, even if, as is and will remain true, there exist no simple scientific rules by the mere application of which such control can be exercised. The management of currency and credit is essentially an art and not a science.

302. In this connection we quote Governor Strong's evidence before the Stabilisation Committee of Congress in 1926 :—“ There is no magic formula that can be introduced into the Federal Reserve

Act to control prices I have discussed these matters with many economists and students of prices and purposely have always carried the discussion through the same course. We have agreed on the record of the past in the Federal Reserve system pretty generally, as to what has been done and the effect of what has been done. We have generally agreed as to the conditions at the present moment. . . . But, when I ask them, ' Now, we have got to decide something to-day ; you are in the position of running in the Federal Reserve system ; what are you going to do to-day that will have an influence on the future ? ' the answer is always the same. ' Well, you are the practical fellows who are running this ; you have got to decide that. ' And that is the difficulty. Our examination of the past produces the most accurate knowledge of past action and re-action, but when it comes to a decision as to what we are going to do for the future, then just human judgment has got to govern. There is no mathematical formula for the administration of the Federal Reserve system or the regulation of prices."

303. The function of a Central Bank should be to regulate the volume and price of bank credit, i.e., " short " credit, so as to maintain output and employment at the maximum compatible with adherence to the international gold standard and with maintenance of the stability of the international price level. Credit is essentially unstable. Credit conditions which tend to generate a rise in prices, lead, if uncontrolled, to still higher prices, and, when the re-action commences, falling prices produce in themselves a further fall. The Credit Cycle in fact on which so much economic research has been expended seems to be the effect of monetary conditions upon human psychology. If we take the depth of a depression, we find easy money, idle balances, but no confidence, and, therefore, reduced investment and reduced output. In time, shortage of stocks, or a fall in the rate of interest, or some other cause, will bring increased demand for goods of some kind or another ; after a period of such increased demand prices will rise ; output and investment will increase, and consequently purchasing power ; the improvement will spread from one industry to another, restoring confidence ; with the increase in profits the readiness to embark on capital outlay will increase. Meanwhile the growth in employment and wages will have increased purchasing power still further and may in time bring actual rises in wages. As the process continues, capital issues become greater and greater until, finally, the new investments in buildings and fixed plant are no longer able to yield the rate of interest or profit upon which their optimistic promoters had been reckoning. At the same time, just when enterprise is beginning to yield less, the over-extension of banking credit will cause an increase in interest rates, and the pressure on the banking system for short-term advances will bring about a certain restriction of credit. Moreover, unless an equivalent rise

in prices is taking place elsewhere, the country's balance of payments may be affected, gold may be exported and pressure on the Central Bank's reserves lead to further restrictions.

304. We have attempted this very inadequate account in order to show that the problem of a Central Bank must be, not only to watch the short-money market, the gold movements and the pressure on the exchange and conditions abroad, but also the internal price level, the unemployment figures and the capital market. Control of credit conditions is always easier before a boom has commenced in earnest. When that has once happened, to prevent its development to a stage ultimately leading to a reaction, and to prevent the reaction running its full course, are both difficult. Yet a Central Bank, if it attempts to curb an upward movement, may and will be criticised for cutting short the country's nascent prosperity. Even when the recent American boom had grown to very great proportions, there was strenuous and widespread opposition in every quarter, even the most authoritative, to any attempt seriously to control it. To the difficulties of the control by a Central Bank of its own market must be added the additional difficulty of securing concerted action by several. Even if it were conceded that such concerted action would generally be effective if it were taken soon enough, it may be argued that it is not in fact practicable to detect and interpret the obscure premonitory signs of the financial weather soon enough or accurately enough, or with a high enough degree of probability, to procure concerted action amongst a number of independent authorities, each of which is likely to have its own ideas based on its local information and to maintain them with tenacity. Here again only time can show. There is no need to minimise the difficulty of the high enterprise which we should like to see the Central Banks of the world put in hand.

305. It is possible, indeed, to prescribe the objective of Central Bank policy. It is possible to suggest ways of increasing the means at the disposal of the Central Banks. But the use made of their discretionary power to vary the value of currency and credit, and the terms on which the latter is granted, must depend on experience and the daily exercise of prescience and a wide discretion. Any great measure of success, indeed, will only be reached as a result of a long process of experiment and evolution. At present, any deliberate effort at stability, however crude in its methods and partial in its success, would be a great improvement. It is sufficient for the time, therefore, to indicate the direction and objective of progress.

6. CONCLUSIONS.

306. We now venture to state our conclusions in summary form as follows :—

- (i) The aim of the Central Banks should be to maintain the stability of international prices both over long periods and

over short periods; i.e., they should both keep the average steady over a period of years and avoid fluctuations round this average from year to year.

(ii) The method of achieving this object should be so to regulate the volume and terms of bank credit as to maintain as much stability as possible in the rate of new investment and new enterprise generally, both at home and abroad. By these means alternate excesses of enthusiasm and depression might be avoided and the demand for the new output of the instruments of production and other forms of capital in the world at large kept in better equilibrium with the proportion of income which is currently available for such purposes—neither in excess nor in defect.

(iii) With this end in view the Central Banks should confer together at frequent intervals to decide whether the general tendency of their individual policies should be towards a relaxation or a tightening of the conditions of credit; and their bank rates and other instruments of credit control should then be adjusted accordingly, without prejudice to their policies relative to one another remaining at the free discretion of each separate institution. Nor should they be afraid of small and frequent changes. For otherwise action may be unduly deferred. Such small and frequent changes would also have the advantage of accustoming the public not to attach undue importance to every necessary adjustment. The Central Banks must be prepared to keep in constant touch with conditions, to make small changes in response to small indications, and to reverse the tendency with any noticeable change in the underlying facts.

(iv) This form of joint policy should be consistent with a full measure of autonomy for each national institution. In particular, each Central Bank should remain free to attract gold to itself whenever it *deliberately* desired to do so, without incurring blame or exciting complaint from the other Central Banks; to raise its own bank rate relatively to that of the others, even though this were contrary to an agreed general policy of reducing rates, if it deemed this to be necessary for the protection of its own gold position; and also to raise its own bank rate for the sake of checking inflationary tendencies at home, even if the tendencies abroad were of a contrary character.

(v) But each Central Bank should undertake to do its best to avoid the importation of unwanted and unnecessary gold merely as a result of leaving natural forces to work themselves out unchecked. It should be the duty of each Bank to avoid an unbalanced international position which was the result of accidental circumstances or the unintended repercussion abroad

of its domestic policy. In particular, if the effect abroad of a curtailment of credit, intended merely to counteract a domestic inflationary tendency, was unintentionally to attract gold, there is a presumption that this effect should be offset by the Central Bank in question being prepared to increase its own balances elsewhere.

(vi) In particular, Central Banks should consider the rate of long-term investment as well as short-term investment as falling within their purview, and should take whatever steps may lie within their power, and are suited to their local circumstances, to counteract any tendency which their own nationals may show either to keep their investible resources excessively liquid or to undertake excessive long-term commitments.

307. Doubtless experience and the natural course of evolution may suggest many modifications in, and additions to, this rough outline. But we have thought that it might serve to crystallise opinion and give aid towards a more coherent scheme of Central Bank collaboration than has existed hitherto, if we were to venture to go further than mere generalities as to the desirability of such collaboration.

II.—PROPOSALS TO MEET THE PRESENT EMERGENCY.

308. The previous section is mainly directed to more or less permanent methods for preserving economic and financial equilibrium internationally. We must now consider what special steps can be taken to escape from the existing position of acute disequilibrium.

309. Chapter IX provides an introduction to this section of our recommendations. We have there explained the difficulties which necessarily arise if the creditor nations as a whole are unwilling to lend to the debtor nations as a whole the surplus due from the latter to the former, after the former have taken all that they are disposed to take in the shape of goods. We think that the first measure towards the restoration of the international price level must necessarily be taken on the initiative of the creditor countries, and that it must consist partly in a greater willingness to buy and partly in a greater willingness to lend. The former will result from a revival of enterprise and investment within the creditor countries themselves; and the latter will permit an increase of purchasing power and a recovery of consumption, to the accompaniment of a revival of capital expansion, in the debtor countries.

310. Failing this the creditor countries will soon have sucked in all the gold available in the hands of the debtor countries and this may entail a series of defaults, preceded, in the effort to avoid such a dishonour, by a severe curtailment of credit and purchasing power attended by a low or falling price level.

311. How little margin there is left for a continuation of what has been happening during the last two years may be illustrated by the following table. The creditor countries comprise Great Britain, the United States, France, Belgium, Holland, Switzerland and Sweden. The debtor countries comprise the rest of the world except Spain and Russia which are included in neither class.

*Gold in Central Banks and Treasuries.**

	January 1st, 1929.		January 1st, 1930.		January 1st, 1931.	
	£ millions.	%	£ millions.	%	£ millions.	%
Creditor countries...	1,277	65	1,391	69.5	1,564	74.5
Debtor countries ...	680	35	610	30.5	531	25.5

* In this table the gold stocks held by Central Banks and Treasuries in 1929 and 1930 have been increased by £23 millions and £19 millions respectively in order to make the figures comparable, as during 1929 and 1930 gold was transferred from private banks in Australia to a total of about £23 millions.

312. Thus in two years the creditor countries have increased their proportion of the monetary gold in the world from two-thirds to three-quarters. The debtor countries probably require amongst them new loans from the creditor countries to an aggregate of not less than £400,000,000 per annum in normal circumstances, unless the creditor countries increase their imports relatively to their exports as compared with what they were before the commencement of the world depression. It appears, therefore, that the total gold stocks of the debtor countries would cover this sum for little more than a year. Moreover, much of the gold is held by those of the debtor countries which are least hard-pressed, and probably at least two-thirds of it is immobilised under the laws regulating their gold reserves. It is unlikely, therefore, that the debtor countries can continue much longer to square their international position by parting with gold at the rate of £70,000,000 a year, as they have been forced to do in the last two years.

313. The efforts of the debtor countries to meet their debts by contracting their imports and expanding their exports may even have the effect of worsening their position through its adverse effect on the prices of their exports. These figures emphasise the impossibility of the debtor countries as a whole meeting their obligations otherwise than out of new loans or by selling more goods at better prices. For the creditor countries to fail in taking steps to relieve this stringency would be exceedingly short-sighted having regard to their own creditor position.

314. It is, however, an important aggravation of the difficulties of solving this problem that it is not possible even for a creditor country to go far in the direction of increasing either its own buying or its own lending unless the other creditor countries are moving more or less in step. For if it does, the claims thus created against it will be used by the rest of the world not to buy more goods but to meet the demands of the other creditor countries. For this reason some measure of co-operation and consultation amongst the creditor countries is highly desirable. This means, in the main, a concerted policy between the Central Banks and issuing institutions of Great Britain, France and the United States.

315. The prospects of such a policy appear to be becoming much more favourable whilst we are preparing this Report. France, in particular, is making preparations for several important issues which are likely to be helpful to the general situation. It may be useful, however, that we should suggest briefly certain general principles of action. The most difficult task is likely to be to find borrowers of sufficient standing to give confidence to investors. We deal with this matter, therefore, rather more fully at the end of this chapter.

(i) The desirability of foreign loans being made by the leading creditor countries on a greater scale than in the past two years should be generally accepted.

(ii) It follows that the Central Banks and Treasuries of these countries should do everything that lies in their power, compatibly with the requirements of their own gold position, (a) to remove any legislative or administrative hindrances in the way of opening their financial markets to the reception of foreign loans, and (b) to permit a volume of domestic credit which will encourage the market to take full advantage of any foreign issues which they may think attractive.

(iii) It is not essential that the loans should be made to the weaker debtor countries. It is often better that such countries should be helped by improving the market for their exports than by enabling them to add to what may be already an excessive burden of indebtedness. A loan to *any* borrower who intends to employ it for increased real investment will, by raising the aggregate of buying power in the world, tend to raise both the prices of commodities and the volume which can be sold and thus to improve the trade balances of other countries. Indeed, a loan to a solvent borrower to finance new productive enterprise is a more radical remedy than a loan to a distress borrower to meet the demands of urgent creditors in respect of past transactions; for it will do much more to make the wheels of the world's commerce go round again.

(iv) It follows that it is not even essential that new loans should be foreign loans, provided that they are for the creation of new

capital assets (though the quantitative effect on the outside world of a loan of a given amount will not be so great if it is for domestic use). For construction programmes within creditor countries will tend to increase the imports of such countries relatively to their exports, and this will relieve the pressure on the debtor countries. If a creditor country is disinclined to lend its savings to a debtor country, then let it employ these savings at home. It is only to do *neither*, but to accumulate, or endeavour to accumulate, the surplus savings in gold, which serves to embarrass the debtor countries as a whole. We repeat that it is the simultaneous reluctance of creditor countries *either to lend or to buy* which is the cause of the crisis. If, for example, the value of the current building and construction in the United States to-day were as great as it was in 1928, the effect of this on the demand for primary commodities and on their prices would cause a large and immediate relaxation of pressure throughout the world. Similarly, the recent decline of the building and construction boom which had existed in France almost ever since the end of the War has much aggravated the effects of the reluctance of the French investor to lend abroad.

(v) It is for these reasons that Central Banks should favour a persistent and determined policy to maintain an abundance of cheap credit in their domestic money markets, sufficient both to satisfy the unusually large demands for liquid resources due to nervousness in the financial world and also to support any new productive enterprises coming forward. Very low rates of discount prevail, it is true, already, but have so far failed to bring about the transfer of money from short-term to long-term loans. The main practical obstacle which we see in the way of a resumption of long-term investment is the shortage of acceptable and willing borrowers for the purpose of new enterprise, due to the general unprofitableness of industry. The task is, therefore, a double one; partly to attract borrowers of unquestioned standing by a low rate of interest on long-term loans, partly to increase the supply of attractive loans. With the first end in view, Central Banks might use their influence to promote confidence in the *duration of low short-term rates* and to persuade the member banks of their system to reduce the rate of interest allowed on deposits, so as to discourage the public from withholding their resources from the investment market.

316. The greatest difficulty, however, which we foresee is the fulfilment of the second task, namely, to remedy the shortage of definitely sound borrowers for the purpose of new enterprise. The vicious circle is complete. The decline of new enterprise has reacted adversely on profits and prices, and the low level of profits and prices stands in the way of new enterprise. It is for this reason that some of us think that in the domestic field it may be necessary to invoke governmental enterprise to break the vicious circle. In the international field measures of an analogous kind

would have to take a somewhat different form. In this case also the vicious circle is complete. The unwillingness to lend, coupled with the frequently unwise use of borrowed funds, has destroyed the credit of borrowers, which reinforces the unwillingness to lend. In many cases, no single creditor is ready to take the risk which is absolutely required in the interest of creditors as a whole. It may be, therefore, that some form of guaranteed credit is required.

317. We believe that certain tentative enquiries have been made by those responsible with a view to discovering whether international action in these matters would meet with general assent. It may be that so far it would have been premature to summon an international conference. But as time passes by the readiness to seek a way out through organised international co-operation is likely to increase.

318. If, therefore, world public opinion was to become ripe, there would be advantages in a general international discussion on what might be described as "The Restoration of International Trade." In this event schemes might be considered for loans guaranteed by a joint fund to which borrowers would contribute a percentage of the sum borrowed in return for the guarantee, any ultimate deficiency on the fund being met by the guarantors.

319. A Government guarantee scheme is only one alternative, perhaps the simplest, although attended with certain dangers which we need not here elaborate. We know that other proposals with the same end in view have been under discussion by the financial authorities of the large creditor countries, such, for instance, as the creation of a private International Corporation with a large capital, partly paid, subscribed by all the big financial institutions in the centres concerned who are interested in foreign loans. Any scheme which meets the end we have in view has our sympathy.

CHAPTER III.—PROPOSALS RELATING TO DOMESTIC MONETARY POLICY.

1. THE NOTE ISSUE.

320. The function of the Bank of England which has been historically the chief concern of the legislature is the note issue. Amending Acts have been passed from time to time, but no change in principle has yet been made in the Act of 1844. The separation between the Issue Department and the Banking Department of the Bank of England and the peculiar form of the Bank's statutory return date from that Act. The Currency and Bank Notes Act of 1928 re-settled the amount of the fiduciary issue and introduced new provisions of elasticity for varying the amount of the fiduciary issue subject to certain conditions; but the principle of the fiduciary

issue was unaltered and its amount was merely adjusted to the existing position arising out of the amalgamation of the Treasury note issue with the Bank's note issue, and was not re-settled on the basis of a fundamental reconsideration of what might be appropriate in the new circumstances.

321. We think that the time has now come for a thorough review and reconsideration of the whole matter. We deal first with the principle of the fiduciary issue and secondly with the less important matter of the separation of the Departments, which is mainly a matter of form.

The Principle of the Fiduciary Issue.

322. The present system of a fixed fiduciary issue (cf. para. 53 et seq.) arose at a time when a large part of the business of the country was conducted by means of gold coins and bank notes, the system of payment by cheque being still imperfectly developed and gold coins and bank notes circulating alongside one another. There had been certain notorious occasions when the Bank of England had put an increased volume of bank notes into circulation, as a result of freely discounting bills, regardless of whether these notes were in substitution for gold or were a net addition to the monetary circulation. The reformers of 1844 thought it desirable to set a limit to the free discretion of the Bank in this respect by enacting that, beyond a fixed sum known as the fiduciary issue, the Bank of England should be prohibited from issuing additional notes except in substitution for gold coin by withdrawing an equal amount of the latter from circulation into the Bank's reserves. Long before 1914 the first stages of credit inflation had ceased to be marked by an increased issue of notes, inflation or deflation being initiated not by changes in the note circulation but by changes in the amount of the Bank's deposits. Nevertheless up to 1914, the old system retained some remaining trace of significance, inasmuch as gold and bank notes still circulated side by side in the country and were legally interchangeable. But with the exclusion of gold coins from the domestic circulation and the confirmation of this exclusion by the Gold Standard Act of 1925, the old system has lost almost entirely its original meaning.

323. In present day conditions when the active circulation of notes is mainly required for the purpose of meeting wage payments and small transactions usually settled in cash, an expansion in the active note issue is likely to be a result of active trade ensuing with an appreciable interval after an expansion in the Bank's deposits. Thus it is the latter which is now the factor of dominating importance, and the somewhat anomalous position arises that while the Bank is not regulated by law in respect of its deposits it remains so regulated in respect of the note issue which was a hundred years

ago the initiating cause of inflation but to-day is the factor which is the latest to be affected by the forces of expansion or contraction.

324. Since, however, the tendency of modern monetary management is, rightly we think, to confer upon the Central Bank increased powers of elasticity in meeting changing conditions, it should not be counted against the present system that it leaves to the Central Bank too great a power of varying the volume of deposits. The criticism to which the present system is open is rather that the principle of the fixed fiduciary issue is wrong in that it associates the amount of the gold which the Bank of England should hold immobilised and unavailable for export with the amount of the active note circulation. Formerly, when the Bank's gold was held for two purposes, partly to meet an external drain and partly to meet an internal drain, it may have been reasonable to earmark a substantial part of it for the latter purpose. But now that the second purpose has disappeared, and has in fact been abolished by law, so that the gold reserve of the Bank of England is held for no other purpose than to meet a foreign drain, the effect of enforcing the principle of the fiduciary issue is to forbid the Bank of England to use by far the greater part of its gold for the only purpose for which it is held or could be used. At present (April, 1931) the Bank holds about £145 millions in gold, at holiday seasons its note circulation rises to about £380 millions and the fiduciary issue is fixed at £260 millions. Thus £120 millions of the gold held by the Bank (the difference between the maximum circulation and the fiduciary issue) is immobilised and at certain times of the year only £25 millions is actually available. On this basis by far the greater part of the gold holding is immobilised when the note issue is at its seasonal maximum, an amount equivalent to about 30 per cent. of the note issue at those periods.

325. We cannot regard as satisfactory a system under which so high a proportion of the gold stock is locked up in such a way as not to be available for export if the Central Bank should so desire. The Act of 1928 indeed recognised the need for elasticity by empowering the Treasury, on the application of the Bank of England, to enlarge the amount of the fiduciary issue for a limited period of time. During the passage of the Bill a statement was made on behalf of the Government, with the concurrence of the Bank, illustrative of the circumstances in which the authority would be exercised. The main points of the statement are shown in the following extracts* :—

“ Clause 8 of the Bill makes a statutory provision intended to be used, not reluctantly and with hesitation in time of crisis, but whenever the Governor of the Bank feels that the present limit on the fiduciary limit is unduly restrictive, to be used, not in defiance of the law, but in

* Hansard, 14th May, 1928, Cols. 744-746.

accordance with the statutory provisions intended for the purpose. . . . We are replacing an illegality by a legal power intended to be used, not in a crisis, but before the crisis arrives. I do not pretend to be able to forecast every contingency which may cause the Governor of the Bank to make the application, and which may make the Chancellor of the Exchequer of the day agree to an increase in the fiduciary issue; but let me examine some of the possible eventualities. . . . An emergency of the type of the crises of 1847, 1857 and 1866 may never recur. Just as in 1847 and 1866 the knowledge that the letter had been issued to the Bank prevented a run upon the Bank, so the provision made in Clause 8 may itself prevent the panic from which these crises arose.

"But a new kind of emergency has become possible. Now that the foreign banks have adopted the practice of accumulating a large reserve of sterling bills, it is always possible that, owing to a change in policy upon the part of those banks, a large sum of gold might be withdrawn in a short time by the realisation of those balances. The probability is that such a measure would be avoided by co-operation amongst the central banks, as was indeed advised in the Genoa resolutions. But if the withdrawal of gold was insisted upon, it might become necessary to extend the fiduciary issue, and that would be an occasion which would justify the Governor of the Bank in asking for that expansion, and the Treasury in granting it.

"A third contingency is the possible competition for gold among the central banks. . . . Should the Bank of England find that, owing to a world demand for gold, credit would be unduly restricted, not as a check on speculation, but to the injury of legitimate requirements, then the Bank can request the Treasury to extend the fiduciary issue and so free gold in the hands of the Bank for further credit operations.

"Moreover, the principle of a fixed fiduciary issue itself necessitates some provision being made for normal growth. It was only by an accidental combination of circumstances that the Act of 1844 did not require an expansion of the fiduciary issue from time to time. . . .

"The provision in the Bill for increase in the fiduciary issue is not intended therefore to be a mere legislative substitute for the crisis letter. On the contrary, it is intended to be used not in a crisis but before it and to prevent undue stringency arising from any of the causes I have mentioned."

326. We think, nevertheless, that as a normal means of providing elasticity, in conjunction with a gold position such as that disclosed in the foregoing paragraphs, the arrangement of the Act of 1928 is open to substantial criticism. With a relatively small free balance of gold, circumstances might well arise that were yet far from emergency conditions, in which it was desirable to let gold flow freely from the country without affecting credit conditions here. It might even be desirable to increase the amount of gold available for export well in advance of this being absolutely required. Yet it seems to us that an approach by the Bank of England to the Treasury for permission to increase the fiduciary issue would be interpreted as a sign of weakness and be the occasion of nervousness at a time when the opposite effect on sentiment was to be desired. While we see no objection to the provisions of the Act of 1928 as the means of meeting a real emergency, we think that their use in relatively normal circumstances is likely to give rise

to great misunderstanding of the position and we believe that it would be preferable that the Bank should have control over a much larger proportion of the total gold stock without calling in aid these provisions. If the object of the fixed fiduciary issue is to tie up the Bank of England, well and good. This may be inadvisable but it is intelligible. But if its object is not to fetter the Bank but merely to require it to make a public declaration of what will be interpreted as weakness, at the most inadvisable moment for creating such an impression, the disadvantages of liberty and of regulation are, it seems to us, heaped on one another.

327. As regards the right principles for regulating gold reserves in the changed circumstances of to-day, we may, without entering into a long argument, summarise our views very briefly as follows:—

(i) If it is thought unnecessary to fetter the discretion of the Bank of England in regard to the volume of its deposits, which in a modern system is the significant and operative factor, there can be no good reason for fettering very narrowly its power to issue notes.

(ii) There are great advantages in a high degree of mobility for the gold reserves of Central Banks. For the task of reconciling international exchange stability with domestic credit stability will be made easier if the Central Bank is free on occasion to allow wider fluctuations in the proportion of its total assets which is made up of gold and comparable items. It is also desirable that the public should become accustomed not to attach undue importance to fluctuations which the Bank has deliberately permitted.

(iii) In present circumstances it is highly desirable that throughout the world the disadvantages of the immobility of gold, and of laws whereby a very high proportion of the world's total stock of gold is rendered sterile, should be modified, and we should not maintain any legislation which conflicts with this aim.

(iv) Nevertheless, it is not unreasonable to regard some part of a country's gold reserve as not belonging to the Central Bank's *masse de manœuvre* for normal daily use, but as an ultimate reserve, not to be brought into consideration in ordinary cases, but kept as a last resort for use only on grave national occasions and after special deliberation between the Government and the Bank. Such a reservation can be justified both by its effect on confidence and in itself.

(v) The proper amount of this ultimate reserve cannot be reached as a fixed proportion of the note circulation (which is the usual principle abroad) or as the excess of the note circulation over a fixed figure (which is the principle of the British fiduciary issue). For it depends on quite different factors from those which determine the note issue. A change, for

example, in the habits of the public in paying by note or by cheque respectively cannot affect the appropriate amount of the gold which we hold against emergencies.

(vi) Just as the amount of gold held by the Bank should be settled independently of the volume of the note issue, so any precautionary limits which it may be thought advisable to set to the Bank's power of note issue should be settled independently of the amount of gold which it is required to hold. The best form of limitation on the discretion of the Bank of England in regard to the volume of its note issue, is, we think, the system which prevailed in France for many years before the War, namely, an absolute maximum subject to modification from time to time by law or by Treasury Minute.

328. We consider, therefore, that the best means of regulating the note issue and the gold reserves of the Bank of England would be the following:—

(a) That Parliament should give the Bank of England power to put into circulation notes to an amount exceeding by a moderate figure what has been found by experience to be the normal note circulation. Thus if we take the seasonal maximum of the present note circulation (exclusive of notes in the Banking Department) at £380,000,000, the absolute maximum beyond which the Bank of England must not go might be set at £400,000,000, this figure being subject to modification by law from time to time. Provision should also be made for additional temporary elasticity by permission of the Treasury on application by the Bank of England similar to the provision in the Act of 1928.

(b) That the Bank of England should by law not be permitted to allow its gold reserve to fall below (say) £75,000,000, except temporarily by permission of the Treasury in accordance (again) with a procedure similar to that laid down in the Act of 1928. In proposing this figure as a *statutory* minimum we do not contemplate that the Bank of England would actually allow its gold to fall so low in any ordinary circumstances.

The Bank of England would thus be given greater freedom for the handling of all normal day to day problems, whilst it would be required, as at present, to confer with the Treasury and obtain its assent whenever highly exceptional circumstances might require some further temporary measures of elasticity.

329. We should add at once, to prevent misunderstanding, that we are not in favour of a reduction in the Bank of England's normal stock of gold. So far from this being the case, we recommend in para. 354 below that the Bank's normal holdings of gold or its equivalent in foreign exchange should, in view of the

large liability of London as an international banking centre, be larger than they have been in recent years. What we envisage therefore in the future is a Bank of England with both increased resources and greater freedom. It is necessary, however, to say that freedom and willingness, if occasion requires, to export gold in considerable amounts presupposes power also to draw it back from abroad in case of need. This again presupposes that this country maintains a sound position in respect both to its Government finances and its balance of payments.

The Separation of the Departments.

330. We now turn to the secondary question whether the existing separation between the Issue Department and the Banking Department of the Bank of England should be continued. This peculiar provision arose out of long-dead controversies which we need not revive; for the reasons which originally led to the separation of the departments have no interest or relevance to-day.

331. The only solid reason, apart from the advantages of continuity and the dislike of changing ancient forms, has been of a different character, namely, that the separation of the Issue Department has provided a convenient formula for dividing the profits of the Bank of England between the Treasury and the Bank itself. This division might of course have been made in a different way and is so made in other countries. But the British system is as follows. Broadly speaking the profits of the note issue belong to the Treasury and the remaining profits belong to the Bank of England; and the segregation of certain assets in the Issue Department allows of the profits of the note issue being calculated, after deduction of certain expenses, by means of the actual net profit earned by these segregated assets taking into account not only the interest earned but also capital appreciation or depreciation. This peculiar arrangement has the effect, however, of making the share of profits accruing to the Treasury depend, not (as might perhaps have been expected) on the volume of notes in circulation or on the earning assets of the Bank, but on the fixed amount of the fiduciary issue. Thus the Treasury share of the profits does not depend on the variable element in the note issue, but only on the earnings of such assets, fixed in amount (at present £260,000,000), as the Bank may choose to set against the fiduciary issue. If, however, it is desirable to calculate the Treasury's share of the profits in this way, it is not necessary to have the paraphernalia of the Issue Department for the purpose. The same formula could be used without a separation of the departments.

332. But in fact, as we have mentioned, the amount of the fiduciary issue is not absolutely fixed. It can be altered by Treasury Minute (as explained in para. 59), subject to certain limitations of time, on the application of the Bank of England. Now if the

fiduciary issue is increased, this has the effect under the present arrangement, other things being equal, of increasing the share of profits which accrues to the Treasury and of diminishing the share which accrues to the Bank of England. This appears to us to confuse in a highly disadvantageous way two matters which ought to be kept separate.

333. Witnesses from the Treasury and from the Bank of England have defended the existing system, on the ground that, if and when the fiduciary issue were to be increased, other things would not be equal. For they presume that this step would not be taken unless the Bank was losing gold and was replacing this gold by earning assets, in which case it is reasonable that the income from these additional earning assets should be assigned to the Treasury. They also told us that even if an increase in the fiduciary issue were to affect adversely the Bank's share of profits, this would have no influence on the Bank in reaching a decision whether or not to apply for such an increase.

334. This seems to us to overlook two considerations. In the first place, if the existing system were retained, it would be a mistake if the Bank were never to apply for an increase of the fiduciary issue except when it had actually lost or was about to lose gold to the full amount of the proposed increase. In the second place, even if the Bank had lost an amount of gold equal to the increase in the fiduciary issue, it does not follow that it would have wholly replaced this gold by earning assets; for the loss of gold ought sometimes to be allowed to have its direct effect of curtailing credit.

335. Thus the separation of the Departments has not, in our opinion led to a satisfactory formula for fixing the Bank's payment to the Treasury. A precautionary increase of the fiduciary issue by no more than £25,000,000 might under the present system reduce the Bank's profits for the time being at the rate of £1,000,000 per annum; and even though the Bank might be entirely indifferent to a loss of this magnitude, it is not reasonable that a necessary piece of public policy should have this arbitrary and perhaps embarrassing consequence.

336. On more general grounds we see no advantage in the separation of the departments. It is confusing and misleading to anyone who is not an expert. In particular the Bank's so-called "reserve" and its so-called "proportion" have quite different meanings from those attaching to these terms elsewhere and lend themselves to erroneous comparisons with other institutions and to an under-rating of the real strength of the Bank of England. It is inconceivable that anyone settling the matter afresh to-day would devise the present form of statutory return. Moreover, if our recommendations made above for the future regulation of the note issue and the gold reserves are adopted, the separation of the departments must necessarily come to an end.

337. We recommend, therefore, that the payment by the Bank to the Treasury should be fixed, as is in effect the case at present, by setting aside the net earnings of certain securities, but that these should not necessarily be of the value of £260,000,000. We suggest that the amount of securities so set aside should vary with the average amount over yearly periods of the excess of the Bank's notes and deposits over its stock of gold and of silver coin. This would protect the Bank from the risk of large variations in its profits arising out of fluctuations, due to considerations of public policy, in the respective proportions of its gold and its earning assets. Without such a provision the Bank might find itself seriously embarrassed on some future occasion if its stock of gold were to rise to a high level without a corresponding expansion of its notes and deposits.

338. We recommend further that the form of the Bank's statutory weekly return should be amended by the amalgamation of the statements relating to the two departments, so that the consolidated Bank return (taking for illustration the actual amounts in round figures for April 29, 1931) would appear as follows:—

	£		£
Proprietors' Capital	14,500,000	Government Securities	274,000,000
Rest	3,500,000	Discounts and Advances	7,000,000
Public Deposits ...	17,000,000	Other Securities ...	39,000,000
Bankers' Deposits ...	49,000,000	Silver Coin	4,000,000
Other Deposits ...	37,000,000	Gold	147,000,000
Notes in Circulation	350,000,000		
	<hr/>		
	£471,000,000		<hr/>
			£471,000,000

339. The above scheme, which recognises the independence of the note issue and the gold reserve and gets away from the false suggestion that the appropriate volume of the note circulation is closely bound up with the amount of gold in the vaults of the Bank, seems to us to be the best.

340. Not only is this the best system for this country. We also attach great importance to it as a first step towards dissociating in the world at large the question of the right level of a country's gold reserve from the question of regulating the note issue. If the view could be generally accepted that gold reserves to-day are held solely to meet temporary deficiencies in the balance of international payments, and if their amounts were determined by what was reasonably necessary for this purpose, this would be the greatest safeguard we can imagine against the risks of a future shortage in the supplies of gold relative to the natural growth of the world's money-income.

341. There is a further matter, though not of fundamental significance, to which we think it desirable to call attention. It seems that a substantial proportion of the "notes in circulation" are not in fact in active circulation at all but are held, many of them

year in and year out, in the safes of the joint stock banks, which are in the habit of holding a much larger proportion of their cash reserves in the form of actual bank notes, instead of as deposits with the Bank of England, than is required by them as till-money.

342. This practice is doubtless due to historical causes. The large quantity of bank notes held by the joint stock banks is a survival from other times, when notes played a much larger proportionate part in making payments, when the banks were much smaller and less able, therefore, to average requirements over a wide area, when communications were slower, and when periodic runs on country banks were still a lively memory. Since large quantities of notes are now held continuously in the vaults of the head offices, it is evident that they are no longer needed for their former purpose. But there has been no incentive to the banks to change their habits, since neither Bank of England notes nor Bank of England deposits earn interest, so that it is a matter of indifference to the banks in which form their cash reserves are held, provided that they have enough bank notes to provide till-money and enough Bank of England deposits to provide for the clearing.

343. The total quantity of bank notes thus held by the English clearing banks has amounted recently to about £105,000,000 and has been steady round about this figure. This represents about 6 per cent. of their deposits. We understand that a smaller quantity of bank notes would be fully enough to provide the banks with till-money. If the Bank of England were to increase the facilities for obtaining notes at short notice, when required, by establishing depots in various parts of the country, some 4 per cent. of their deposits might be sufficient. This would enable the clearing banks to pay up to (say) £40,000,000 in bank notes into the Bank of England, and to increase their deposits with the Bank of England to an equal extent, without any inconvenience to themselves. We may mention that the Federal Reserve System of the United States has recognised the desirability of the member banks keeping their legal reserves in the shape of deposits with the Central Institution, and not in bank notes, by providing that only the former reckon towards a member bank's reserve requirements, till-money being for this purpose excluded.

344. If the banks were to do this, the effect would be to decrease the active note circulation by a corresponding amount and to increase the bankers' deposits with the Bank of England by the same figure. Incidentally it would mean that the present artificially inflated figures of note circulation would be reduced to an amount which corresponded to the notes actually in circulation, so that the Bank return would present a truer picture of the situation. At present the possession of these surplus notes gives the banks a certain influence over the state of the Bank of England's

return, which they may value—though it is not one which, in our opinion, they ought to have. For it enables them to affect the Bank of England's published "reserve" and "proportion" within quite wide limits, according as they choose from time to time to exchange deposits at the Bank of England for notes and *vice versa*. Changes of this kind are, at present, a most disturbing feature of the Bank's return; for it is impossible to know whether changes in the notes taken out represent a real increase in the circulation or merely a manoeuvre on the part of some joint stock bank. This fact reinforces the desirability of the change of principle which we recommend above, since after this change has been made it will make no significant difference whether the clearing banks hold notes or Bank of England deposits. But for the same reason it will make it a matter of indifference to the clearing banks themselves how they hold their reserves and thus remove any reason for reluctance which they might otherwise have felt in falling in with our suggestion to pay in notes.

345. If this proposal were adopted, it should be for consideration whether the maximum figure for the note issue should not be fixed at some lower figure than £400,000,000. Its adoption would also, it is true, greatly mitigate the practical evils of continuing the present fixed fiduciary system; indeed it might in effect give the Bank of England more latitude than our own proposals. But it would not meet the point of principle or achieve the important object of separating explicitly the question of gold reserves from the question of note issue. It would merely provide a means of rendering the existing system of regulation a dead-letter, without establishing any right principle in its place.

346. Finally, we think that it would point the right road to further progress if some provision were made, in the event of other Central Banks accepting a similar provision, for balances with the Bank for International Settlements to be allowed, at the discretion of the Bank of England, to reckon for all purposes of the law as the equivalent of gold. This provision might be of the highest value in the future course of the evolution of international banking and would provide an important precedent in the development of methods of international banking practice for the economy of gold. In the event of the Bank for International Settlements failing to develop along the lines which would make it advisable for use to be made of this discretionary power, the Bank of England would, of course, be free to make no use of it. In any case this suggestion is not directed to the immediate situation, but is, rather, a matter for consideration in connection with long-distance monetary policy.

2. THE RESOURCES OF THE BANK OF ENGLAND.

347. The outstanding characteristic of the London money and investment markets has been the comparatively small amount of the resources of the Central Institution in relation to the vast amount

of the international financial business transacted in the City. So far from this being anything new, it carries on the traditional pre-war system. This pre-war system depended on the extreme liquidity of London's claims on the rest of the world. In 1913 the sterling bill was the foundation of the system; a large part of the outstanding volume of such bills represented acceptances on behalf of foreign clients; and consequently any measures taken by the Bank of England to curtail the volume of sterling bills resulted within a few weeks in the maturing of claims by London on the rest of the world. The Bank of England chose, therefore, mainly to depend on its power to contract the volume of acceptances by its control of the money market, and was content, having this power, to economise in the amount of its other liquid resources.

348. The Bank of England still has this power in an uncommon degree and can still afford to place great dependence upon it. But relatively to the growth of other factors, its efficacy is less than it was. It is advisable, therefore, to review the position in the light of the facts and figures of to-day.

349. We pick out the following elements as deserving particular notice :—

(i) The figures given in Appendix I show that the volume of sterling acceptances on behalf of overseas clients has fluctuated widely in the course of the last four years, varying between a minimum of £123,000,000 in June, 1927, and a maximum of £203,000,000 in June, 1929.* But these figures are dwarfed by the Treasury Bills in the market, which is a new feature since the War, the amount of these Bills, outside Government Departments and the Issue Department of the Bank of England, fluctuating during the same period between £472,000,000 and £525,000,000. Moreover, since the War an acceptance market in New York has been organised on a considerable scale. Dollar acceptances on foreign account have fluctuated in the four years 1927-30 between £107,000,000 and £200,000,000.†

(ii) It has been explained to us that there is some connection between the volume of sterling acceptances for foreign clients outstanding at any time and the volume of bills and deposits held in London on foreign account. Consequently, fluctuations in the volume of sterling acceptances outstanding are partly offset by corresponding fluctuations in the volume of bills and deposits held in London on foreign account. Thus, the maximum fluctuation in the excess of such bills and deposits over sterling acceptances on foreign account is less than the maximum fluctuation in either of these elements taken separately, being no more than £50,000,000 in the course of the four years for which we have statistics.

* Taking half-yearly dates.

† Taking end of the year dates.

(iii) Before the War London's short-term position with the rest of the world was probably well balanced. To-day her gross liabilities for foreign short-term bills and deposits are largely in excess of her claims in respect of her acceptances. (Account cannot be taken of our deposits abroad since figures are not available.) This is mainly due (as is also the case in New York) to the magnitude of the abnormal French deposits held in London and to the growing practice on the part of Central Banks and other banks abroad of holding a large portion of their liquid resources in this way. This may be expressed by saying that London is now practising international deposit banking, as distinct from international acceptance business and the deposits associated with this, on a larger scale than before the War.

(iv) There is a new feature, closely associated with (iii) above, which is at the same time a convenience and a danger. Not only is London conducting a larger business than formerly as a depository of international liquid funds, but so also—and on a still greater scale—is New York. This means that there is a substantial quantity of such funds ready to move from one money market to another, according to the attractions of the rate offered. It follows that changes in the short-term rate of interest in London relative to New York are even more potent than before the War in regulating the *net* position of our international balance sheet. Perhaps they are too potent, for part of the relief comes in a different, and less desirable, way than formerly. A rise in discount rates in the pre-war money market functioned mainly by calling in our claims on the rest of the world through the contraction in the volume of our acceptances. A rise in discount rates to-day is more liable to function in part by increasing our liabilities to the rest of the world through the attraction of short-term funds from abroad. Thus, the ease with which we can for a time meet claims on us by attracting precarious short-term deposits, while it is certainly a great convenience, may also be a danger unless we avail ourselves of it only with the greatest moderation and prudence.

(v) The volume of foreign long-term financing which is ready to offer itself in London, provided that terms can be arranged, is much greater than it used to be relatively to the annual surplus which we have available for this purpose. This applies not only to the new issue market, but also to the large volume of so-called "international" stock exchange securities which find a ready market in, and move easily between, different international centres of finance. In particular, foreign government bonds and the like which are issued in New York in the first instance are subsequently almost as likely to find a home here as in the United States. Moreover, our annual surplus for new long-term foreign investment is not only smaller absolutely than it used to be, but is also smaller relatively to our total annual savings and to the scale of the market and is subject to sharp fluctuations, amounting to as

much as £100,000,000, according to the estimates of the Board of Trade (see Appendix IV), between one year and the next.

350. All this may be summed up by saying that there is much more risk than there used to be of our financing long-term investment by means of attracting short-term foreign funds of a precarious character, and thus gradually slipping into a less liquid position than is desirable. This may result in our having to maintain short-term rates over a long period at a level inappropriate to domestic requirements in order to retain the precarious foreign funds which we have inadvisedly employed in a non-liquid way.

351. Or we may put it thus. Before the War our liquid international assets mainly consisted of the Bank of England's gold and our sterling acceptances on foreign account. These were believed to be, as a rule, at least equal to and sometimes substantially in excess of our short-term international liabilities. To-day we have greatly increased the latter as a result of the development of our functions as a depository of international short-term funds, whilst the former have not been increased correspondingly, with the result that our liabilities may be as much as double our liquid assets, reckoning these as made up of our acceptances and our surplus gold hitherto available for export. Regarded in this way our total position is much less liquid than formerly, whilst the use of our traditional balancing factor, namely bank rate, may operate as much by increasing our short-term liabilities as by calling in our short-term assets. To these latter should, of course, be added our deposits abroad held at short notice, for which we have no figures, but even so we believe the position to-day to be less liquid than before the War.

352. Our conclusion is that the Bank of England's liquid assets ought to be increased at the first opportunity to a substantially higher figure and maintained thereafter at this higher figure as the normal. At the same time we should be prepared to see without concern very wide fluctuations in the aggregate of these assets. We think that the instrument of bank rate should be used sparingly when the objective is merely to balance moderate changes in the short-term position by attracting foreign funds and not to affect the domestic situation. Bank rate is rightly used when the Bank of England deliberately desires to contract credit either at home or in the world at large. Its use is of much more doubtful utility when there is no desire on the part of the Bank to contract credit either here or abroad, the main point of maintaining a high bank rate being to attract foreign funds. The temporary contingencies which the attraction of foreign funds is intended to meet would often be better met in the opposite way, that is to say, by the Bank relinquishing its own liquid assets rather than by borrowing liquid assets from abroad. This course would not only be more prudent, but it would be much more effective in circumstances in which, apart from the exigencies of the short-term position, the wish of the Bank would be to relax credit conditions in the world at large.

rather than to contract them. For rising rates in London must have a tendency to contract credit everywhere, whereas if London were both in a position to release gold and other liquid assets and willing to do so, it would have a precisely opposite tendency—which is what will be desired in the circumstances assumed.

353. For these reasons we consider that the pre-war system in this country under which only relatively small fluctuations in the gold reserve of the Bank of England were permitted, and bank rate was operated with this end in view, needs to be supplemented to-day. We think that in the modern world, having regard to the scale of international operations and the size of other money markets, the Bank of England should feel itself free to see, without anxiety, very large fluctuations in its own liquid assets between their minimum and their maximum. The magnitude of London's international operations to-day requires, that is to say, that the normal level of the Bank of England's liquid international assets should be materially higher than it now is, that these liquid assets should exist to be used at not infrequent intervals, and that money markets at home and abroad should be made accustomed to view these fluctuations as a sign of strength and as a part of the Bank's regular machinery for the control of credit. We consider that at present the disparity between London's liquid resources and those of other large international countries is too great and should be diminished.

354. The recommendations which we have made above regarding the fiduciary issue would have the effect of releasing for this purpose a larger proportion of the gold already held than is available at present. But this would not be enough by itself. It would enable the Bank's stock of gold to fluctuate between extremes of (say) £175,000,000 and £100,000,000. But for the Bank to raise its stock of gold above the former figure might be undesirable unless the present pressure on the supply of gold becomes relaxed or other Central Banks become content with a smaller normal figure for their own gold reserves. Thus it would seem advisable for the Bank to supplement its gold reserves by liquid funds held abroad either in other important financial centres or perhaps with the Bank for International Settlements if that institution evolves in a manner suitable to this purpose. We suggest, therefore, that in addition to gold reserves fluctuating between (say) £100,000,000 and £175,000,000, the Bank might maintain other foreign liquid resources fluctuating in amount up to £50,000,000. A part of these foreign resources might belong to the securities allocated against the note issue. But even so some increase in the total resources of the Bank of England might be required. We make a proposal bearing on this in paragraph 370 below.

355. We must emphasise, however, that there is one important corollary to the freer use of its liquid resources by the Bank of England based on normal holdings of an increased amount. The

Bank must not be tempted into meeting by exports of gold an adverse position of a character for which bank rate and a contraction of credit is the appropriate remedy. The exchanges may prove adverse to us either on account of a trade or investment expansion at home of an inflationary character or on account of the movement of capital items resulting from the performance of our functions as a centre of international finance. We recommend an increase in the Bank's resources and a free use of these increased resources in appropriate circumstances, because our business of international banking on a great scale may prove incompatible with the reasonable stability of domestic business and enterprise if we cannot afford to allow a movement of even ten per cent. in our liquid international liabilities without taking steps most upsetting and sometimes highly injurious to our domestic trade. But it must not be inferred from this that we are in favour of any hesitation in the use of bank rate and credit contraction when the immediate problem of management is to check boom conditions or rising prices at home and is not primarily concerned with movements of foreign capital.

3. THE DAY-TO-DAY POLICY OF THE BANK OF ENGLAND.

356. The chief means at the disposal of the Bank of England for the management of the monetary system are the following :—

(1) The official bank rate.

(2) " Open-market " operations (or the deliberate refraining from them) which, after taking account of the changes, if any, in the Bank's gold reserves and in the Public Deposits, have the effect of changing the aggregate amount of the Bank's Private Deposits.

(3) " Open-market " operations which consist in changing the form of the Bank's assets without changing their quantity. This may take any of three forms :—

(i) The Bank may offset movements of gold by buying or selling securities ;

(ii) The Bank may sell short-dated securities (e.g. Treasury Bills), and at the same time buy long-dated securities (e.g. Consols) ;

(iii) The Bank may force the market to discount or obtain advances on the official terms, with the object of bringing market rates into closer conformity with these, by selling securities (which might be regarded as a variant of (2) above).

(4) There are certain technical devices for directly influencing the foreign exchanges, namely, sales or purchases of foreign balances (i.e. so-called " gold exchange " methods), dealings in forward exchange, and small variations in the Bank's buying price for gold.

(5) The use of the Bank's personal influence over, or advice to, prominent elements in the money market.

357. Of these (1) was the traditional instrument, upon which chief emphasis was laid in all pre-war accounts of the Bank's methods. We have explained in paragraph 352 above our reasons for thinking that this instrument should be used sparingly for temporary adjustments of the international balance of payments and should be mainly reserved for occasions when the Bank deliberately wishes to contract or to expand credit either at home or in the world at large. We have also indicated in paragraph 221 the difficulties which arise in employing the instrument of bank rate when the ultimate requirement is to secure a substantial reduction in the general level of money-incomes. But between these extremes of purely temporary adjustments at the one end and exceptional long-period adjustments at the other, there are many contingencies for dealing with which the instrument of bank rate as traditionally employed by the Bank of England is excellently suited—in particular the control of the Credit Cycle and the regulation of the rate of slow, normal change in the level of money-incomes so as to maintain conformity between money-incomes at home and abroad.

358. Since the War method (2) has been greatly developed and perhaps plays the major part in the case of the smaller day-to-day movements, as contrasted with larger changes. We think that the evolution of the Bank of England's methods in the direction of a greater reliance on the habitual use of open-market operations has been wisely conceived and should be developed further. There are, however, two respects in which the Bank of England's position for the effective use of this method might be strengthened. Hitherto the Bank has had no accurate information as to the quantity of cash held by the clearing banks, whereas it is the aggregate of these banks' cash and Bank of England deposits which determines the amount of credit which they create; nor has the Bank had accurate information as to the division of the deposits of the clearing banks between current accounts and fixed deposits, whereas a change in the volume of credit produces different consequences according as it corresponds to an increase in current accounts or in fixed deposits. The volume of the bankers' deposits with the Bank of England (taken in conjunction with their holdings of bank notes which, as may be seen from Table I in Appendix I, have been remarkably steady) is the main determinant of the volume of domestic credit, and the question of the right amount of these deposits, from week to week as circumstances change, should, we think, be a main pre-occupation of the Bank of England. As appears from Sir Ernest Harvey's evidence, this is, in fact, one of the matters to which the Bank pays attention. But judging from the average amount of these deposits quarter by quarter in recent years (cf. the table in para. 167), we are not clear whether enough allowance has always been made for changing circumstances. On the other hand, the fluctuations of the bankers' deposits at the Bank of England over shorter periods

may be, from the clearing banks' point of view, more frequent and more unpredictable than they would be if the Bank were to depend for its management of the market rate of discount day by day less on restricting or expanding the banks' cash and more on direct co-operation with the banks and on the substitution of one kind of asset for another within the Bank of England's own resources. The Bank of England's difficult task of regulation may, we hope, be made a little easier by the adoption of some of our other proposals, in particular those for an increase of the detailed information at the disposal of the Bank, for a more precise understanding as to the cash reserves maintained by the clearing banks, and for a closer collaboration between these banks and the Bank of England.

359. Method (3) has doubtless been employed by the Bank from time to time, especially in cases (i) and (iii). But deliberate exchanges between the Bank's holdings of long-dated and of short-dated securities respectively, with the object of influencing the margin between the market rate of interest on the two types of securities, may not have played in the past as important a part in regulating the rate of investment as they might. We think that the policy of bringing to bear such influence as the Bank may possess for widening or narrowing the margin between long-term and short-term rates of interest in different sets of circumstances, with a view to encouraging fixed investment or liquidity as the case may be, should be frequently considered and should sometimes form the basis of action. Very often the Bank may be able to bring to bear all the influence which it needs to exercise on the long-term rate of interest by operating on the short-term rate, which has usually been considered its more direct concern. But occasions may arise when this will not be sufficient.

360. The methods which we have grouped together under (4) have played no great part hitherto in the Bank's scheme of control. We have already proposed above (para. 354) that "gold-exchange" methods might properly play a greater part to-day than formerly, and have recommended that the Bank should increase its interest in international liquid assets other than gold. We have also had before us proposals relating to the forward exchanges and to a widening of the gold points with a view to increasing the power of influencing the movement of foreign funds through changes in the margin between the spot and forward rates of foreign exchange. These are matters of detailed technique which the Bank of England will no doubt be ready to consider; but they lie somewhat beyond our own competence and we make no recommendation.

361. We come finally to method (5), that is to say to the Bank's personal influence over the other elements in the money market. These elements fall into four groups:—(a) the Money Market proper; (b) the Issuing Houses and the Accepting Houses; (c) the great Clearing Banks.

362. The contact between the Bank of England and the money market proper is adequately close and successful. The practice of frequent meetings between representatives of the Bank and the leading bill brokers by which the wishes and intentions of the Bank are confidentially communicated to the latter needs no improvement.

363. The contact between the Bank and the leading issuing houses is also intimate. We understand that important foreign issues made by these houses are seldom underwritten in London unless the Governor of the Bank of England has been first consulted and that any opinion he may offer will carry great weight. The weakness of this control arises in a different way. It is partly due to the possibility, and often the probability, that foreign bond issues may be made elsewhere and then or subsequently be to a large extent re-offered in London.

364. Coming to the third group, the great clearing banks, we think that there might with advantage be closer contact between them and the Bank of England. Our suggestions on this head follow in the next section.

4. THE RELATIONS OF THE BANK OF ENGLAND WITH THE JOINT STOCK BANKS.

365. In the United States the member banks of the Federal Reserve System are required by law to maintain balances with their Reserve Bank bearing a specified relation to their deposits. Their till money is not allowed to reckon for this purpose. The proportion of reserves to deposits actually held depends on the division of the member banks' deposits between demand deposits and time deposits. But in practice it has worked out in recent years at a percentage between .7 and .9 of the deposits, in addition to till money of about 2 per cent., making in practice about 9.5 per cent. altogether.

366. In Great Britain there are no legal requirements. But for some time past, subject to one exceptional movement, the actual practice of the ten London clearing banks has not changed. They publish monthly figures of reserves in cash and at the Bank of England which up to 1927 averaged 11.7 per cent. of their deposits and now (owing to a change of practice on the part of the Midland Bank which used to keep a higher reserve than the other banks) average about 10.8 per cent. The interpretation of this figure is subject, however, to the two observations following.

367. The banks have not distinguished in their published statements between their holdings of Bank of England (or Treasury) notes and their deposits with the Bank of England. They have,

however, furnished us with separate figures for these two items, which may be summarised as follows :—

(Annual averages of monthly figures omitting June and December.*)

	Cash in hand (£ 000).	Per Cent. of Deposits.	Balance with Bank of England (£ 000).	Per Cent. of Deposits.
1919 ...	110,733	7.5	86,915	5.9
1920 ...	105,567	6.2	74,855	4.4
1921 ...	111,216	6.4	90,741	5.2
1922 ...	108,744	6.4	88,395	5.2
1923 ...	104,604	6.5	83,333	5.2
1924 ...	103,714	6.4	83,640	5.2
1925 ...	104,448	6.5	81,209	5.1
1926 ...	103,786	6.5	80,715	5.0
1927 ...	106,067	6.4	78,746	4.8
1928 ...	105,011	6.2	77,877	4.6
1929 ...	105,067	6.1	76,934	4.4
1930 ...	103,880	6.0	78,362	4.5

* These months are omitted because of the exceptional half-yearly window-dressing operations which are discussed later.

368. Thus of the total ratio of 10.5 per cent. here shown only 4.5 per cent. is held in the form of balances with the Bank of England. As we have already indicated in paragraph 79 the latter figure is, however, not quite what it appears to be. The monthly figures published by the clearing banks are not true daily averages but are averages of one selected day in each week of the month. It seems that, in order to present a better appearance, most of the banks concerned are at pains to manipulate their balances with the Bank of England on the selected day of the week so that they stand at a higher figure than usual. Moreover, each of the four biggest institutions pursuing these practices selects a different day of the week for the purpose, calling in loans from the money market on its own selected day, but returning them next morning in time for the next big bank to call them for its making-up day. Thus a certain part of the published reserves of the clearing banks in the shape of deposits with the Bank of England is like a stage army, the same liquid resources doing duty four times over in the course of each week. At the end of each half-year the same practice, euphemistically known as "window-dressing," is followed on a grander scale. On these occasions other banks which only publish figures at these dates also make a brave show in their balance-sheets with deposits at the Bank of England, which they temporarily acquire for the purpose. The net result is that the average Bank of England balances of the clearing

banks are less than 3.5 per cent. of their deposits (perhaps not more than 3 per cent.) and those of the banks of the country as a whole less than 3 per cent.

369. We have made some attempt to estimate the magnitude of this practice. A comparison of the balances with the Bank of England as published by the clearing banks with the bankers' balances (which include other accounts besides those of the clearing banks) as published weekly by the Bank of England suggests that the monthly "window-dressing" has the effect of increasing the apparent cash reserves of the clearing banks by at least £20,000,000 over the true average figure. In the case of the end-year window-dressing the aggregate deposits with the Bank of England offered by the banks of the country as a temporary display on December 31st—the only figures with which most of them supply their shareholders and their customers—appear to be about £75,000,000 in excess of the figure normally held.

370. We are not aware that these practices serve any useful purpose. We think that they are not creditable to our banking system; and we recommend that they should be given up at once. Our recommendations on this and allied matters are as follows:—

(1) The monthly statements now published by the clearing banks are the result of pressure put upon them 40 years ago by Mr. Goschen, then Chancellor of the Exchequer. Certain recommendations for changes were made subsequently by the Cunliffe Committee, but only one bank (Lloyds Bank) has adopted them in full. Their form is not now as useful as it could be and is capable of certain improvements. We recommend that the banks should be asked to publish their statements in future in the form set out in Chapter V which substantially corresponds with the form in which, at our request, they have kindly furnished us with their figures for recent years.

(2) In these monthly statements the returns made of the cash in hand and of the balances with the Bank of England should be true daily averages.

(3) We have shown above that the reserves now published by the clearing banks are, omitting June and December, about 10.5 per cent. of their deposits, made up of 6 per cent. in Bank of England notes and 4.5 per cent. in balances with the Bank of England. We recommend that the London clearing banks should aim at the maintenance on the daily average of each three-monthly period of an amount of cash in bank notes and balances with the Bank of England of not less than 10 per cent. of their deposits.

(4) For banks other than the London clearing banks, we have not available the statistical information necessary to make a definite recommendation as to their cash balances. Under present arrangements they often need to hold balances with their clearing agents, but we do not know the terms upon which such balances are held.

We think it possible that machinery could be devised under which these balances would be held at the Bank of England and operated upon by the clearing agents. The position of the Scottish banks is, moreover, complicated by the arrangements in connection with their note issues. We think, however, that the banks other than the clearing banks should aim at the maintenance on the daily average of each three-monthly period of an amount of cash in bank notes and balances with the Bank of England of a given percentage of their deposits and we recommend that the appropriate percentage should be arrived at in each case after consultation with the Bank of England.

These proposals would probably involve some increase in the amount of reserves held by the banks, so that it would place on them a small additional burden. It needs, therefore, to be justified in the public interest. In a modern banking system, where member banks are in a position to hold earning assets which can be quickly turned into cash at the Central Institution, indirectly as in Great Britain or directly as in most other countries, the amount of reserves which they require strictly for their own safety and convenience may be extremely small. Since their reserves earn no interest, there will, therefore, be a tendency to whittle them down gradually by one means or another to the lowest figure which will not disturb public opinion. Moreover the main reason for expecting the banks to keep reserves above the minimum needed for daily convenience is no longer primarily the safety and solvency of the banks themselves, as it was in former times, but the necessity for providing the Central Institution with adequate resources wherewith to manage the monetary system and safely furnish the member institutions with precisely those conveniences, for rapidly liquidating earning assets, upon which the latter depend when determining the amount of their cash reserves. Thus the appropriate amount of the reserves of the member banks cannot now be left to their own individual self-interest but must be governed by the proper requirements of the system as a whole.

In a country such as France, where bank notes still play a very important part, the resources held by the Central Bank against the note issue may be fully adequate to its requirements and the question of the balances held with the Central Bank by its member banks may be a matter of comparatively small importance. But in countries such as Great Britain and the United States, where the great bulk of the business of the country has come to be transacted by cheques, this is not the case. The substantial question before us is, therefore, the adequacy of the resources of the Bank of England for all possible contingencies.

We have already expressed the opinion that the resources of the Bank of England ought to be augmented with a view to increasing both the amount of its own liquid reserves and the amount of its earning assets available for various types of open-market operations.

Since 1913 there has grown up in the United States their great Federal Reserve System with aggregate deposits more than three times the banking deposits of this country. Against these deposits, reserves approximating $7\frac{1}{2}$ per cent. must, in practice, be maintained with the Federal Reserve Banks, which also have the advantage of resources held against a substantial note issue. As a result the average deposits held in 1930 by the member institutions with the Central Institution in the United States and in Great Britain respectively compare as follows :—

				£
United States	...	...	...	488,000,000
Great Britain	...	...	...	65,000,000

This disparity is far greater than that of the magnitude of the two banking systems or of their international responsibilities. We feel that it has only to be stated in order to carry the conviction that our leading banks should be expected to contribute somewhat more to the strength of the Central Institution. Some small proportion of the revenues of our banks could be spent in no better way than in thus strengthening our monetary system at its foundations. For the quantities which were appropriate to pre-war conditions are no longer in scale for a country which intends to maintain its position as one of the chief financial centres of the modern world.

(5) The adoption of these recommendations would provide some increase in the resources of the Bank of England. But it would not, we think, provide a sufficient increase in view of the considerations which we have urged above. We suggest, therefore, that the Bank of England should consider an appropriate increase in the amount of its capital.

(6) We think that there might sometimes be an advantage in allowing a slight elasticity on the initiative of the Bank of England in the reserves recommended above for the joint stock banks. That is to say, the power to relax or tighten up this figure might be a useful addition to the Bank of England's means for effecting a relaxation or contraction of credit. We make the suggestion, therefore, that as to a variation within certain narrow limits, the banks should accept the advice of the Bank of England as to the average figure at which they should keep their reserve balances—the Bank indicating to them from time to time the advisability of a change (which probably should be quite small on any one occasion). The advantage of this technique, as compared with open-market operations, would lie in the fact that the Bank of England is somewhat narrowly limited by custom in the classes of securities which it can buy or sell, whereas the effect of an alteration in the reserve proportions of the joint stock banks could be spread over the whole of the assets of those banks.

Whatever ratio of reserves be fixed as suitable, it is in any event most important that it should be rigidly adhered to by the banks. For the power of the Bank of England to control the aggregate volume of credit in the country by means of open-market operations and other measures essentially depends on the rigidity of this ratio.

(7) We have carefully considered whether our recommendations as to the cash reserves to be maintained by the banks should be given statutory effect or whether they should be left to the good-will of the banks concerned. We think that there are substantial advantages in the traditional procedure of this country by which our banks are not subjected to any special legislation. It would be preferable, therefore, that these recommendations should be carried into substantial effect by agreement between the Bank of England and the banks concerned. All the matters in question are perfectly susceptible of settlement by agreement since those who would be the parties to such an agreement are responsible and substantial concerns and few in number. We should hope, therefore, not to find any serious difficulty in the way of such a solution.

371. There remains the question whether any improvement or extension is possible in the present system of consultation and co-operation between the Bank of England and the large clearing banks. The evidence which we have received has given us the impression that these relations might with advantage be somewhat closer than they now are. It is a result of causes originating in the now distant past that there is still a degree of aloofness and remoteness in the daily relations between the Bank of England and the clearing banks which does not exist, for example, between the Bank of England and the merchant banks, the leading issuing and accepting houses, and the bill-brokers.

372. This is a matter upon which it is, of course, impossible to make precise recommendations. But we suggest for the consideration of those concerned that it might be extremely useful if there were frequent and regular meetings between representatives of the Bank of England and of the clearing banks, at which opinions would be exchanged in a free and intimate manner, the clearing banks taken into the confidence of the Bank of England to a greater degree than seems to be the case at present, and their co-operation invited with a view to making the policy of the Bank of England fully effective.

373. Perhaps we may usefully give a few examples of the sort of cases we have in mind where such co-operation might be useful. The joint stock banks play a much greater direct part than formerly in attracting foreign deposits to this country, since they accept such

deposits at rates of interest which do not always bear the same relation to the market rate of discount. It is well that there should be a harmony between their policy in this regard and the wishes of the Bank of England. Again, we consider that the rates allowed by the clearing banks on fixed deposits should not always be determined as at present but sometimes with a view to influencing the public to be more or less willing, as the varying circumstances may require, to employ their savings in less liquid forms.

374. Above all, it is desirable that the clearing banks should be made aware in the plainest possible manner whether the general tendency of the policy of the Bank of England at any time is towards a relaxation or towards a contraction of the conditions of domestic credit. At present a small expansion by the Bank of England in the basis of credit may be employed by the clearing banks in the bill market in a way which may weaken the foreign exchanges, merely because of their uncertainty whether the small expansion which they have observed represents definite intention or is merely an accidental reflection of other forces and will probably be reversed soon afterwards.

CHAPTER IV.—PROPOSALS RELATING TO THE CAPITAL MARKET FOR HOME INVESTMENT.

375. Each great financial centre has its own characteristics. But the City of London can still claim to be the most highly organised international market for money in the world. Its freedom and elasticity are without parallel. Its accepting houses and its discount market provide unequalled facilities for the financing of national and international commerce; whilst the former, in their capacity as issuing houses, play a large part in the placing of international issues of a long-term character. Lastly the great British joint stock banks have the pre-eminent merit that their financial strength and liquidity are beyond any question. It may be that we are too far removed in this country from the days of great banking failures and panics, and the ruin following from the destruction of confidence, to esteem at its proper worth the enormous value of an impregnable banking system.

376. It is noteworthy, however, that, speaking generally, the exceptional merits of the City of London lie in the facilities given by the short-term money market for the employment of home or foreign funds; in the financing of trade and commerce, also both home and foreign; and in the issue of foreign bonds, as distinguished from the financing of British industry. The combines facilities offered by the accepting houses and the discount market have for very many years been made use of by bankers, merchants and traders throughout the world; they have been equally available

to, and have in fact been largely made use of by British merchants and traders. In so far as these facilities have not been even more largely made use of by the latter, the reason must lie in the fact that they have been able to find all the credit they wanted as cheaply or even more cheaply from the joint stock banks themselves. But the relations between the British financial world and British industry, as distinct from British commerce, have never been so close as between German finance and German industry or between American finance and American industry.

377. For the peculiar characteristics of the London money market we must look naturally to its history. England has always been a great commercial and trading as well as a great industrial nation; commerce in fact preceded industry. It was in London that this commerce centred and London was the great entrepôt for trade between the Continent and the rest of the world. London's financial organisation adapted itself to the needs of this world-wide commerce and it was there that the great private merchant banking houses settled and flourished. On the other hand, when British industry began its great growth in the nineteenth century, there was no particular reason why it should look to the London market for its financial requirements. Industry in those days was, so far as each unit was concerned, on a comparatively small scale; its basis was in the main a family basis, as the names of many of the great English businesses still show; its capital was provided privately and it was built up and extended out of profits; in so far as it required banking facilities, it found them from the independent banks, often family banks, which in general had their headquarters in the provinces, and particularly in the Midlands and the North, where the new industries flourished. Moreover, there had existed for many years in this country a large class of investors with means to invest, who exercised an independent judgment as to what to invest in, and did not rely as in some countries entirely on their bankers. Industry therefore, though making full use of the ordinary banking facilities offered by the joint stock banks, maintained its independence of any financial control.

378. In Europe, particularly in Germany, there has been a different relationship between banks and industries, and bankers have been forced to associate themselves more closely with industrial development. This is not because industrialists there were more ready than in England to share the control of their businesses with bankers or financiers, or that bankers would not, conditions being otherwise, have willingly adopted the attitude of their English confrères. It arose rather out of the necessities of the situation—from the scarcity of capital and of independent investors. Industry started later in these countries than with us. In order to compete with us, it required more help than it could obtain from its own private resources or from the public, whose power of investment was small, and the banks were driven to assist industry

to obtain permanent as well as short-dated capital. Accepting these heavy responsibilities, they were obliged to keep in more intimate touch with and maintain a more continuous watch over the industries with which they had allied themselves than were the English banks. The following quotations from the evidence given to us by Dr. Goldschmidt indicate in broad outline the German system :—

“ It should never be forgotten that Germany owes the great industrial development of the sixties, the nineties and the first decade of this century in a large measure to what one may well describe as this ‘ entrepreneur ’ spirit in banking. . . . The relationship between a bank and an industrial or trading company commences with the latter’s foundation. Scarcely a single important company in Germany has been founded without the collaboration of a bank. Whether it is a case of converting a private firm into a limited company, or of exploiting a new invention by establishing a new enterprise, the assistance of a bank is always invoked. The bank examines the situation and, when necessary, obtains reports from experts in the particular line. . . . If the bank, after examination, decides to found the company, it draws up the scheme of financing, determines the amount and the type of capital to be issued, and then, in some cases, itself takes a part of the shares into its security portfolio with the idea of issuing them at a later date. In this way the founding bank becomes at the same time the issuing bank, the latter functions beginning, however, only with the introduction of the shares to the Stock Exchange through the intermediary of the bank.” (*Statement of Evidence, paras. 5-6.*)

379. In France on the other hand, while investment capital was greater than in Germany, the individual investor was, speaking generally, a very small capitalist, unwilling to exercise an independent judgment. He therefore relied almost entirely on the investments suggested to him by the big banks which made practically all the industrial issues and thus assumed a measure of responsibility for them towards the public. The connection between banks and industry thus established, while less intimate than in Germany, was much closer than in England. In addition, in Paris, certain powerful banks developed a great and influential business, not as ordinary joint stock banks of deposit like the English banks, but as “ *banques d'affaires* ” more closely interested in industry and development of all kinds both at home and abroad.

380. In the United States conditions were again entirely different. But it was to the development of American industry in the widest sense that the financial world of New York devoted itself rather than to international finance. The great industries and the railroads were affiliated in general to particular banking

houses, and in the building up, and in particular in the merging, of most of the great American corporations, some house or bank has played a leading part, with the consequence that the relationship between them has usually remained a close and continuous one. It may be said that all industrial issues of well-known companies are sponsored by some responsible issuing institution; the smaller issues by smaller firms, the larger by large firms or large banks. In both cases it is common for a group of issuing institutions to combine in making the issue. In every case the names of the issuing institutions appear prominently on the prospectus, so that the public are left in no doubt as to who is sponsoring the issue. Taking this responsibility, the issuing institution naturally attempts to keep in close and continuous touch with the company after the issue. So far as the large banks in New York, Chicago and other centres are concerned, the issues in which they are interested are made usually through subsidiary Securities Companies. Moreover, the American banks are closely concerned with industry from another aspect. The banks lend either directly or through brokers very large amounts of money to investors and speculators against industrial securities of all kinds. The loans of this kind made by Reporting Member Banks are sometimes at least equal to the loans made direct by them to industry. For this reason also the banks take a great interest in the stock market and in the industrial securities quoted there.

381. Thus, under a different system, American banks, private and public, perform for American industry substantially the functions that German banks perform for German industry. The connection is a looser one; the number of banks competing is far greater; the problem of finding the necessary capital no doubt is much easier; and industry often needs banking assistance far less. Yet at the same time the American banks engage their issuing credit in the eyes of the public for the soundness of the issues they support, and this very fact leads, as it must always do, to a closer and more intimate association between banks and industry than where no such responsibility is assumed.

382. But, while this cursory account indicates—what indeed is a truism—that differing historical conditions have led to different developments in each country, it is necessary to consider much more closely what, under modern conditions, is likely to be the relationship between finance and industry most beneficial to the community at large, before we can judge whether there are any improvements which can be made in the case of this country.

383. Taking first the very broadest view over the modern world, we believe that in any community which wishes to keep in the van of progress the financial and industrial worlds should be closely integrated through appropriate organisations. Bankers, or financial leaders, who are in touch with the leaders of finance

in other countries, who have a thorough knowledge of the economic and financial conditions, not only of their own, but of other countries, and who are in a position to watch and to judge of the underlying changes taking place in those conditions, should be able, if they are in confidential and continuous relationship with industrialists, not only to supplement the information at the disposal of industrialists themselves but also to give aid of very great value in all financial problems.

384. Industry is yearly becoming more internationalised, and British industry, if it is not to be stranded in a back-water, will find institutions closely in touch with international finance invaluable in many ways as intermediaries. British companies in the iron and steel, electrical, and other industries must meet in the gate their great American and German competitors who are generally financially powerful and closely supported by banking and financial groups, with whom they have continuous relationships. British industry, without similar support, will undoubtedly be at a disadvantage. But such effective support cannot be obtained merely for a particular occasion. It can only be the result of intimate co-operation over years during which the financial interests get an insight into the problems and requirements of the industry in question and the industrial interests learn the value of the support which financial interests can give. The future development of British industry, particularly in the establishment of enterprises abroad, is greatly dependent on co-operation of this character, since a knowledge of foreign conditions, farsighted planning and large supplies of capital will be, or may be, all required. And in the realm of foreign investment it is primarily towards British-owned enterprises abroad that we should wish to see our energies and capital turned rather than merely towards subscribing to foreign Government and municipal loans, which absorb our available foreign balance while doing little for our industry and commerce. So far as heavy industry is concerned, we may find ourselves cut more and more out of the world if our competitors, advancing with combined and powerful industrial and financial resources, develop abroad one "tied" enterprise after another, or in the alternative purchase from us enterprises previously "tied" to us.

385. In the last few exceedingly difficult years it would have been of high value if the leaders, for instance, of the steel or ship-building or other industries had been working in the closest co-operation with powerful financial and banking institutions in the City with a view to their reconstitution on a profitable basis. The tasks still confronting us require great financial as well as industrial experience. It has been represented to us strongly in evidence that a great deal remains to be done in more than one important industry in overcoming sectional and individual opposition to

desirable amalgamations and reconstructions designed to eliminate waste and cheapen costs. It was stated to us that very important economies and much greater efficiency are possible if there are concerted movements to that end. We believe this to be the case and we believe also that these results can often only be obtained if there is some independent authority (such as a financial institution) able to review an industry as a whole from outside, to suggest plans of re-organisation, and to assist in the provision of finance. But industrialists on their side must be willing to co-operate. There are grounds for supposing that progress has been often very slow from the fact that the industrialists interested have not been ready themselves to take any wide view or recognise the enormous changes now taking place in the world and in methods of production. The greatest possible reduction of costs is particularly essential in our basic industries and in industries which are in competition with foreign countries since only by this means can their future be secured. We are not in a position to go into detail in this matter, but we desire to express a strong opinion that sectional interests should not be allowed to stand in the way of re-organisations which are in the national interest.

386. In a second direction we see advantages in a closer co-operation of industry and finance. It is all-important to the community that its savings should be invested in the most fruitful and generally useful enterprises offering at home. Yet, in general, the individual investor can hardly be supposed to have himself knowledge of much value either as to the profitable character or the security of what is offered to him. How easily he can be misled in times of speculative fever by glittering—even tawdry—appearances is proved by the experience of 1928, as the following striking figures will show.

In that year the total amount subscribed for capital issues whether of shares or debentures of 284 companies was £117,000,000. At 31st May, 1931, the total market value of these issues as far as ascertainable was £66,000,000 showing a loss of over £50,000,000 or about 47 per cent. In fact the public's loss has been greater since many of these shares were no doubt sold by the promoters at a high premium. Still more striking perhaps, 70 of the above companies have already been wound up and the capital of 36 others has no ascertainable value. The issues of these 106 companies during that year amounted to nearly £20,000,000.

387. That you cannot prevent a fool from his folly is no reason why you should not give a prudent man guidance. We believe that our financial machinery is definitely weak in that it fails to give clear guidance to the investor when appeals are made to him on behalf of home industry. When he is investing abroad he has the assistance of long-established issuing houses, whose reputation is world-wide. When subscriptions to a foreign issue are invited by means of a public prospectus, it is almost certain

that that issue will be vouched for by one of these issuing houses whose name will be evidence that it has been thoroughly examined and the interests of the investors protected as far as possible. For the issuing house's issuing credit, which can easily be affected, is involved, and it is very highly to its own interest to make sure that the issue is sound. If, as must from time to time happen, something goes wrong with the loan or the borrower the issuing house regards it as its duty to do everything it can to put matters straight, and, indeed, to watch continuously the actions of the borrower to see that the security remains unimpaired. These duties are sometimes very onerous and involve a great deal of labour and expense, as well as judgment, skill and experience.

388. Contrast this with nearly all home industrial issues. There are, it is true, one or two first-class houses in the City which perform for certain first-class companies the same functions as the older issuing houses perform for foreign borrowers. In addition these latter are to a limited extent entering the domestic field, though, for the reasons we give later, their direct interest must probably remain limited. Again, the advice of stockbrokers, when asked for, may be a safeguard but it is scarcely sufficient to take the place of the responsibility of a first-class issuing house. With these exceptions the public is usually not guided by any institution whose name and reputation it knows. For in the main all issues are made in the same way. Each of them has in the most prominent position and in much the heaviest type on the prospectus the name of a joint stock bank—in the great majority of cases one of the "Big Five"—as receiving subscriptions to the issue. It is perfectly natural that an inexperienced investor, seeing the name of a well-known bank on the prospectus, should believe that the bank in question vouches in some way for the issue. But he is mistaken. None of the Big Five regard themselves, except in very rare cases, as fathering the issue or in any way responsible for it beyond seeing that the prospectus complies generally with the law and that the issue is on the face of it respectable. None of them would wish the public to assume that they vouched for the issue and the figures of profits and assets, etc., given in the prospectus, in the same way as the issuing houses vouch for their issues. They frequently know the company through having had banking relations with it over a series of years. On the other hand, they may know practically nothing of it. The *real* issuer may be the company itself, if it is a strong and good one, or a finance company or syndicate—few large, many small, some good, some indifferent, some bad—and sometimes it is a company or a syndicate got together for the sole purpose of making a particular issue. The investor may not realise that the all-important point is not the name of the bank receiving subscriptions but that of the company or syndicate really responsible for the issue; the

more doubtful the issue the more likely it is that this name will appear in very modest and retiring print. In the case of big, first-class companies, the names of which are a sufficient guarantee in themselves, and which probably issue their own securities, this system is adequate. But in most other cases the public is left without a guide, with the results which we have indicated above. It would in our opinion be an important reform that relations between finance and industry should be so developed that issuing institutions of first-class strength and repute should vouch to the investor more normally and more fully for the intrinsic soundness of the issues made and that the joint stock banks should not give the appearance of sponsoring issues so long as in fact their real responsibility is limited to receiving subscriptions. In this way the investor would be encouraged to support well-vouched issues and be put on his guard against others.

389. It is important, however, to recognise clearly that no financial institution which assumed the responsibility of vouching for industrial issues could do so on the basis of an isolated connection formed with the industry solely for this purpose. Responsibility of this kind can only be the outcome of a close and continuous relationship with the industry concerned, different in kind from the relationship now existing between the joint stock banks and industry.

390. While from the investor's point of view there would be undoubted advantages in a closer connection between British industry and the City of London, we think that the financial community and industry would both benefit. We believe it not unfair to say that certainly in American and German banking circles, and possibly in French also, there would be found many more men with an intimate knowledge of the problems of industry than in England. Certainly in all these countries it is easier to obtain immediately from banking sources full and accurate information on any particular industry and on any particular company in that industry. A really big American bank for instance would have a large department engaged in studying particular industries and the companies engaged in it, in keeping in close touch with developments and in being ready to provide any information required. If those at the head of our financial world have a close knowledge of industry, they will be far more able to assist in meeting the problems of the future than if finance and industry are in watertight compartments. We have indeed no sympathy with the idea that the banks should in any way manage industry. We endorse Dr. Goldschmidt's statement that "a banker must never forget that he cannot and must not be an industrialist. He can only play his real part in assisting a company by concentrating on the tasks and possibilities which present themselves from time to time in the case of every industrial enterprise. It is and must be the rule

that the industrialists themselves should be responsible for the business and general management of a company and that the banker should be the adviser in matters of finance." (Statement of evidence; para. 14.)

391. Every industrial and commercial company has a double financial problem, namely, to provide itself with adequate permanent capital and to obtain, as occasion warrants, temporary or seasonal credits, either of a self-liquidating character or to be repaid ultimately out of the issue of more permanent capital. It may also have—and perhaps in increasing measure—a third problem, namely, to provide itself with what are known as intermediate credits. Short-dated credits are endless in the variety of their conditions, and to provide them is the principal function of the banks. As such advances form the most lucrative part of their assets the banks indeed are very willing to do so, so long as their total lies within their customary percentages and within the limits set by general credit policy. In this direction British industry certainly suffers under no handicap in comparison with its competitors. The great English banks, undoubtedly among the strongest financial institutions in the world, use and have used their resources freely, sometimes too freely, in the provision of advances to industry. In general we are satisfied that, subject to the conditions imposed by the necessity of accommodating ourselves to the outside world, our banking system is adequate and satisfactory in the provision of the normal short credits to industry and their distribution. It is appropriate to say here and in connection with short-term credit that all concerned would benefit by a more extended use of commercial bills (i.e. bills given by a purchaser to a supplier) which have largely disappeared as part of the mechanism of home business. To those who find it necessary for good reason to give extended credit, finance would be rendered more easy if their "accounts receivable" were in the form of commercial or trade bills rather than in the form of mere debts.

392. There are two other questions; whether our financial organisation is as fitted as it might be to supply industry (i) with intermediate credit and (ii) with long-dated capital.

393. Intermediate credit may be defined generally as credit advanced for periods ranging from one or two up to five years. It is necessary, we think, to divide into at least three main classes the types of transactions for which intermediate credit is required, namely: (i) hire purchase or instalment sales, (ii) advances against deferred payment, (iii) long-term contracts.

Class (i) would cover the sale of various classes of goods of which the legal ownership can be retained by the seller until payment is completed, e.g., motor cars, motor lorries, pumps, electrical machinery and appliances, agricultural implements, and so forth. These classes comprise articles represented in general by small

units which can be claimed and removed by the seller if payment is not ultimately completed.

Class (ii) would cover the sale of larger units such for instance as ships, also coke-ovens or machinery which after erection is not removable and the ownership of which, therefore, passes in fact from the seller. The security therefore no longer resides in the goods themselves and the seller must rely to a greater extent on the soundness of the buyer and on such other security as he can obtain.

Class (iii) would cover large contracts for railways, harbours, roads, drainage, water-works and so forth.

394. In the case of all these classes, we believe that adequate credit facilities for use internally in this country are available and are being developed, but that in the case of Classes (i) and (ii) not so much use is made of them as is possible and desirable. Recent experience appears to show that, on proper lines and with sound supervision, the risk of loss in the granting of such credits is small, while on the other hand their value in stimulating home consumption should be great. The use of electrical and mechanical appliances by the great bulk of the population is capable of very great extension and would, we believe, be greatly facilitated by the more widespread application of instalment buying, the advantages of which much outweigh in our view any disadvantages which are alleged against it. It is, of course, essential that British traders should be made fully aware of the facilities which exist and that they in turn should be prepared to make use of them.

395. We do not feel so sure, however, that credit facilities to cover sales or contracts abroad are so adequate, particularly in the case of Classes (i) and (ii). With the immense growth in the mechanisation of industry throughout the world, the demand for longer credits for financing the production and sale of machinery of all kinds appears to be growing. The purchaser abroad requires very often two or three years before he can complete his payments, and therefore contracts are likely to go to those sellers who can provide sufficiently long credit. Since we must look in the future particularly to exports in which skill and experience largely enter, we believe that facilities for financing exports of machinery of all kinds are of particular importance. At present, however, we do not believe that the facilities available here in the case of foreign trade are so complete as those provided in some other countries, and we think that it would in fact often be necessary for British traders to obtain either directly or indirectly such facilities from foreign institutions. This is a situation which should be remedied and British institutions, similar to those which cover the ground satisfactorily at home, should be developed for the purpose of assisting British industry and trade abroad. We see no reason why sufficiently strong institutions should not create a market for their own short-term securities by means of which any sound business negotiated might be financed.

396. As regards Class (iii), namely, long-term contracts abroad, British contractors will normally be in competition with foreign contractors. Such contracts are usually for account either of Governments or municipalities, and, as the work is often extended over some years, loans to finance them are required only gradually, and generally the authority for which the work is being carried out pays as each section of it is completed. The risks of any bank or financial institution taking up the business are first that the Government or public authority will be unable to pay; secondly, and more important perhaps, that disputes as to the carrying out of contracts will arise; and thirdly that, if the contractor were to fail, the bank might be forced to make its own arrangements to complete the work. In the past the names of the great British firms have been known in every part of the world. The first essential to-day is that the new generation of contractors should have adequate financial resources of their own. In that case we believe that the joint stock banks and other existing institutions should be able to provide at any rate some of the credit facilities required. It is true that longer credit facilities are needed in such cases than it is customary for banks to give. But up to a certain small proportion of their advances the banks would run no undue risk in financing sound contracts of this character. We suggest, however, that the financing of such contracts should be more particularly one of the functions of the class of institution to which we refer below. Foreign contractors undoubtedly obtain such facilities more easily than British contractors and it would be a misfortune if the latter were, on account of their inability to obtain the financial assistance required, to have to withdraw from a field in which Great Britain has been so prominent in the past.

397. Coming back now to the more general question of the relations between finance and industry, and in particular to the provision of long-dated capital, we believe that there is substance in the view that the British financial organisation concentrated in the City of London might with advantage be more closely co-ordinated with British industry, particularly large-scale industry, than is now the case; and that in some respects the City is more highly organised to provide capital to foreign countries than to British industry. We believe this to be due in part to the historical organisation of British industry and to the fact that industry, having grown up on strongly individualistic lines, has been anxious to steer clear of anything which might savour of banking control or even interference, this attitude coinciding with the views which prevail in this country as to the province of sound banking. Nevertheless a further development of our financial organisation is possible, which would be distinctly beneficial and need not be inconsistent with these traditions.

398. We are bound to point out, however, that unless British industry can at any rate be reasonably assured of normal profits no development such as we suggest has any chance of success. No institution acting as an intermediary between industry and investor can possibly succeed unless the securities which it induces the latter to buy prove to be sound and remunerative. Any concern devoting itself to industrial financing faces peculiar difficulties, for it must have a considerable capital and yet it is without a "bread and butter" business such as ordinary deposit banking or acceptance business provides.

399. The functions which should be performed by such a concern may be summarised as follows:—Acting as financial advisers to existing industrial companies; advising in particular as to the provision of permanent capital, its amounts and types; securing the underwriting of and issuing the company's securities to the public and, if necessary, assisting previously in arranging for the provision of temporary finance in anticipation of an issue; assisting in financing long contracts at home and abroad, or new developments of an existing company, or founding companies for entirely new enterprises; acting as intermediaries and financial advisers in the case of mergers or in the case of negotiations with corresponding international groups; and generally being free to carry out all types of financing business.

400. These are functions which are often difficult, which entail considerable risks and which may involve the temporary locking-up of large sums.

Such a concern must:—

(a) be provided with a substantial capital: where it is a case of financing large contracts for periods up to five years, it might be able to supplement its resources by the issue of its own short-term notes;

(b) be able to rely on the co-operation of existing institutions with large monetary resources in the making of temporary advances: otherwise it might either be unable to carry out its functions or its capital might have to be too big for it to earn satisfactory dividends;

(c) build up a competent and expert staff; establish gradual connections with industry; and instil confidence in its issuing ability and credit.

401. We have considered whether these are functions which the big joint stock banks might themselves carry out. They have the great advantages (i) of representing such aggregations of capital and deposit resources that their financial capacity would be undoubted; (ii) of being, through their immense number of branches and through the large sums they already lend on short credit, in touch with industry in a way not possible for anyone

else. But for various reasons we think it doubtful whether the banks can with advantage depart from their traditional banking sphere.

402. For other reasons the same conclusion seems necessary as regards the great private banking houses. These houses, with very few exceptions, undertake a large acceptance business involving them in a corresponding liability to the holders of their bills. It has always been recognised that acceptance business necessitates the maintenance of a high degree of liquidity and is not consistent with serious liabilities in respect of industrial financing.

403. While, however, we do not propose a change in the character of present banking practice, we think that the co-operation of the big banks is required both in taking an interest in the share capital of such an institution and being ready to provide such credit facilities as the institution may require pending a public issue. The best course might be if the leading private institutions and the big banks were to co-operate in creating one or more such concerns. We understand that the creation of the Bankers' Industrial Development Company was due originally to the belief that help in these directions might be given to industry by the City, which was not being given. We have been told, however, that the authorities of the Bank of England consider, as we do, that these are not proper permanent functions for a subsidiary of a Central Bank. It would seem desirable, therefore, that the Bankers' Industrial Development Company should at a convenient stage be definitely separated from the Bank of England, have an independent existence, and rely upon its profit-making capacity as a private institution. It is possible that it might form a nucleus for that closer co-operation between finance and industry which we think is required.

There is no reason why the field should be limited to any one institution. In fact it is too wide for that to be desirable. In practice, any concern entering it might find that some specialisation over one or two particular industries was desirable. We must repeat, however, that the success of institutions directing themselves to the interests of British industry must depend finally on the profit-making capacity of that industry. They may help by their co-operation towards that end, but industrial problems must in the main be solved by industry itself.

404. It has been represented to us that great difficulty is experienced by the smaller and medium-sized businesses in raising the capital which they may from time to time require, even when the security offered is perfectly sound. To provide adequate machinery for raising long-dated capital in amounts not sufficiently large for a public issue, i.e., amounts ranging from small sums up to say £200,000 or more, always presents difficulties. The expense of a public issue is too great in proportion to the capital

raised, and therefore it is difficult to interest the ordinary investor by the usual method; the Investment Trust Companies do not look with any great favour on small issues which would have no free market and would require closely watching; nor can any issuing house tie up its funds in long-dated capital issues of which it cannot dispose. In general, therefore, these smaller capital issues are made through brokers or through some private channel among investors in the locality where the business is situated. This may often be the most satisfactory method. As we do not think that they could be handled as a general rule by a large concern of the character we have outlined above, the only other alternative would be to form a company to devote itself particularly to these smaller industrial and commercial issues. In addition to its ordinary capital, such a company might issue preference share capital or debentures secured on the underlying debentures or shares of the companies which it financed. The risks would in this manner be spread, and the debentures of the financing company should, moreover, have a free market. We see no reason why with proper management, and provided British industry in general is profitable, such a concern should not succeed. We believe that it would be worth while for detailed inquiries to be made into the methods by which other countries attempt to solve this particular problem.

CHAPTER V.—PROPOSALS RELATING TO INFORMATION AND STATISTICS.

405. Exact quantitative knowledge concerning the chief elements of the monetary and financial system is, we consider, of the utmost importance, both to provide the necessary data on which to base the management of the system and also for the purpose of making gradually possible a more definitely scientific treatment of these problems than the existing state of our knowledge of the facts allows. There are, moreover, many matters of importance which are now the subject of controversy, yet need not be so if they could be put to a statistical test. We should aim, therefore, at obtaining a complete inventory of the economic life of the community under its several aspects in such a form that we could cross-check the accuracy of our information by being able to work up to the final totals from more than one direction.

406. Except in the case of unemployment statistics which are required for administrative purposes, this country (which was the pioneer in statistical surveys) has been falling seriously behind the United States. We think that a substantial annual sum could not be better spent than on the strengthening of the statistical departments of the appropriate Ministries, and that in course of time a

corpus of reliable knowledge could be built up which might save us from mistakes involving a waste of resources worth many hundreds of times the total cost of acquiring the knowledge. There can be few worse perversions of the ideal of wise economy than a narrow limitation on what we spend for the improvement of economic knowledge.

407. We are hopeful that a moderate impulse in this direction may be sufficient at the present day to produce valuable results, because we see signs in several directions of a far greater willingness than existed a few years ago to impart business and financial information. Several of the clearing banks have begun to publish figures supplementary to those traditionally required of them; and we understand that the Bank of England has taken steps of late with a view to a development of its activities in the collection of statistical information.

408. The statistical information, the collection of which we recommend, can be divided into that part which is of a definitely monetary or financial character, and that part which covers the industrial and economic field in general. But both are equally necessary for the purposes of the scientific management of the currency. For the second category of statistics is as essential as the first for the correct and prompt diagnosis and prognosis of the position and prospects from day to day.

We recommend, therefore, that the following sets of statistics be collected as completely and as promptly as the circumstances permit:—

I. MONETARY AND FINANCIAL STATISTICS.

1. THE MONTHLY RETURNS OF THE CLEARING BANKS.

409. These should be amplified on the lines, broadly speaking, of the returns for recent years with which the clearing banks have kindly supplied us as published in Appendix I. More particularly, they should show separately:—

- (i) Cash in hand (true daily average).
- (ii) Balance at the Bank of England (true daily average).
- (iii) Money at Call (a) in sterling.
(b) in foreign currencies.
- (iv) Money at Short Notice (a) to the Money Market.
(b) to the Stock Exchange.
(c) in foreign currencies.
- (v) Treasury Bills.
- (vi) Commercial Bills (a) in sterling.
(b) in foreign currencies.
- (vii) Loans and Overdrafts.
- (viii) Current Accounts (exclusive of internal funds and accounts of the bank itself).

- (ix) Deposit Accounts (inclusive of internal funds and accounts of the bank itself).
- (x) Investments (a) in British Government securities.
(b) in other Securities.
- (xi) Acceptances outstanding (separately from engagements for forward foreign exchange, etc.).

2. CLASSIFICATION OF LOANS AND OVERDRAFTS.

410. Certain of the banks have prepared from time to time a classification of their aggregate of loans and overdrafts corresponding to the different classes of their customers. In the evidence which they have given us they have kindly amplified these particulars; but hitherto this classification has not been made regularly, or on a uniform basis, or as comprehensively as might be. We recommend that the banks should be invited to prepare at annual intervals (or at quarterly intervals if that be practicable) a classification of their total loans and overdrafts on some such broad lines as the following—

- (a) Loans to concerns engaged in "productive" industry (mining, manufacture, etc.);
- (b) Loans to concerns engaged in commerce, transport and distribution;
- (c) Loans to concerns engaged in finance, insurance, etc.;
- (d) Loans to agriculturists;
- (e) Loans to concerns and persons engaged in professions, entertainments, personal services, etc.;
- (f) Loans to private persons:—
 - (i) for house building;
 - (ii) for other purposes;

Each of these general headings, and particularly (a), should then be sub-divided further so far as is practicable. In fact, in some cases the banks have already proceeded to more details than the above. It would be helpful if care could be taken to sub-divide class (a) into industrial classifications which correspond as closely as possible to the classifications used in other industrial statistics (*cf.* para. 423).

3. RETURNS FROM THE OTHER JOINT STOCK BANKS.

411. It is at present a serious gap in the aggregate banking statistics of the country that no figures are available for British joint stock banks other than the clearing banks except at dates (at the end of the year or of the half-year) which are not representative of the normal position. We recommend that the Treasury or the Bank of England should be asked to prepare a list of the institutions which should be reckoned as being "banks" for the purpose of making statistical returns—a list which might be limited, if it seemed advisable, to joint stock banks with deposits in excess of

(say) £1,000,000. These institutions should be asked to supply the Bank of England with the same information as that for which we ask in the case of the clearing banks, and aggregated totals might be published monthly.

4. RETURNS FROM OTHER INSTITUTIONS.

412. There remain three important classes of institutions not covered by the above, namely the merchant bankers, British banks doing business mainly abroad though having their head office in this country, and foreign institutions with branch offices here accepting sterling deposits. It would be a great advantage if periodic statements of their sterling deposits could be obtained from all these institutions. These returns might be quarterly rather than monthly, and there would be no objection to the institutions in question being allowed to furnish the figures privately to the Bank of England, which would have the duty of publishing aggregated figures only.

5. FOREIGN BALANCES AND FOREIGN LIQUID ASSETS HELD IN STERLING.

413. We attach first-class importance to these figures being collected as comprehensively as possible and published. We have ourselves made a first attempt in this direction and have printed the results in Appendix I. Whilst these figures probably cover by far the greater part of the ground, there are doubtless omissions and defects which could be remedied with further experience; the most important omission is that of sterling bills held in their own portfolios by foreign institutions, whether located in London or abroad. We recommend that the Bank of England should be charged with the duty of collecting these statistics to the best of its ability. We think that the figures are more likely to be accurate and complete if the returns for individual institutions are treated by the Bank of England as confidential, only the aggregated results being published. We attach importance to these results being made public at monthly intervals. In the long run the advantages to confidence and prestige of the figures being known will far outweigh any supposed advantages from suppression. We believe that a knowledge of the figures which we have collected relating to recent periods would have increased confidence, if they had been known at the time. No doubt if the amount of the gold reserve had not been published hitherto some fears might be entertained as to the results of publication. So it may be in this case. But for those who would stand high in the world's estimation the greatest candour and readiness to submit to publicity are now required. Moreover, it is exceedingly desirable that the principal data on which the Bank of England bases its decisions should be generally known. For the natural action of the market is more likely in that case to march

- (ix) Deposit Accounts (inclusive of internal funds and accounts of the bank itself).
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with the intentions of the Bank and the decisions, being intelligible, will carry more weight.

We suggest, at the same time, that it might be useful for the Bank of England to collect for its own confidential use somewhat more detailed information than could easily be obtained for publication, since figures affecting the position of individual foreign institutions would be involved. In particular, the separate confidential returns made to the Bank of England might be divided up according to the country on behalf of whose nationals or institutions the bills and balances were held.

6. THE VOLUME OF ACCEPTANCES.

414. Hitherto no figures have been available for the aggregate of sterling acceptances outstanding in London on home and foreign account respectively, such as are available for dollar acceptances in New York. Even the figures for "Acceptances, etc." published by the clearing banks are liable to be deceptive, because with acceptances some of them have lumped together engagements for forward foreign exchange and other items. This is a serious gap in our picture of the financial position.

We recommend, therefore, that the Bank of England should collect comprehensive figures and publish the aggregated results at monthly intervals. In this case also the figures for individual institutions should be treated as confidential, whilst the Bank might find it useful that the confidential returns made to it should be divided up according to the domiciles of the parties on behalf of whom the bills have been accepted.

With the figures of bills and balances held, and of bills accepted on foreign account, the Bank of England will be in possession of essential data which are at present lacking. The burden of meeting liabilities to foreign institutions, should repayment be claimed, or if the net result of a great number of transactions some one way and some the other happens to be adverse, must necessarily fall on the Bank of England. Yet hitherto the Bank of England has been, as it were, in the position of a head office, charged with the maintenance of adequate reserves yet without accurate information either as to the volume of deposits and other liabilities incurred by its branches, or as to the liquid *contra* assets held by them in the shape of maturing acceptances.

7. THE VOLUME OF CHEQUE TRANSACTIONS.

415. We have at present detailed figures, admirably compiled by the officials of the Clearing House, of the volume of cheque transactions passing through the "clearing" in London and the chief provincial centres. Unfortunately these represent an incomplete

and somewhat arbitrary selection from the aggregate of cheque transactions, or "bank-debits" as this aggregate is called in the United States. For they exclude transactions between customers of a single bank which are settled internally and have no need to pass through the Clearing House (and, owing to the concentration of British banks into a small number, the amount of these is now large); and they also exclude cheques which are informally cleared between neighbouring banks in towns or localities where there is no "provincial clearing."

The total turn-over figures have in fact been given to the Board of Trade by the ten clearing banks since January, 1930, but they have not been published hitherto either by the Board or by the banks themselves. We print them in Appendix I. We recommend that similar figures should be obtained from all banks and published at monthly intervals. We suggest, further, that they might be subdivided into a number of groups according to the districts where they arise. The districts chosen should cover areas comparable to those used in other industrial statistics.

In general it should be borne in mind in any method of classification which is adopted that an important object of these figures is to make it possible to separate, so far as practicable, the figures arising from Stock Exchange and money market transactions from transactions arising out of the earning and spending of the community's current income.

416. We suggest that the Bank of England might usefully publish a monthly bulletin of statistics including the material which, we understand, the Bank already compiles for the information of foreign and Dominion Central Banks, and also the fresh material which would become available as the result of the preceding recommendations.

8. THE BALANCE OF TRADE.

417. We recommend that the figures now published annually by the Board of Trade, making up our international balance sheet of the items due to and by this country on income, and in part on capital, account, should be placed on a more exact basis. The figures for recent years, which we print in Appendix IV, have doubtless been the best obtainable without elaborate special inquiries for making which the necessary resources have not existed. But they have been partly based on pioneer private enquiries, made by *The Economist*, Sir Robert Kindersley and others; they have been subject in recent years to frequent (and large) revisions after publication; and it is evident that there is so much guess-

work in them as to render them liable to an unduly wide margin of inevitable error. We believe, however, that it is only a matter of taking sufficient pains to make them reasonably accurate and that it is thoroughly worth while to do this.

The collection of the figures of foreign bills and balances, which we recommend above, will go a long way towards making this possible, since the lack of such figures is the greatest gap in the compilation. But there are also other items which might be put on a more exact basis. In particular the amount of the receipts in respect of sinking funds on existing foreign loans, on which Sir Robert Kindersley has thrown much light and which he has shown to be substantial, should be regularly and precisely ascertained from the banks and issuing houses concerned. Foreign holdings in British companies, as to which *The Economist* has made some most interesting sample inquiries, should be ascertained in detail. The net proceeds to the borrower of new foreign issues currently made in London should be supplied in every case by the issuing houses. Brokers and banks (including foreign brokerage and banking houses with London offices) should be required to make returns of the volume of securities purchased and sold by them on foreign stock exchanges for British clients, and on British stock exchanges for foreign clients—vital facts, all estimates concerning which are at present pure guess-work. The estimates of the miscellaneous items forming part of our so-called "invisible exports," such as shipping earnings, acceptance commissions, insurance premiums, brokerages, tourist expenditure, emigrant remittances, etc., should all be placed on a more secure basis of ascertained fact.

Then only shall we know with sufficient accuracy the trends and changes of the financial position of this country *vis-a-vis* the rest of the world.

II. GENERAL INDUSTRIAL AND ECONOMIC STATISTICS.

9. THE CENSUS OF PRODUCTION.

418. The foundation of the general industrial statistics of this country is the periodical Census of Production. All economic enquirers owe an immense debt to the first-class pioneer work performed by the Board of Trade from the first census of 1907 onwards. But we think that the time has come for a great extension of this work and for the provision of the much larger resources necessary to secure a prompt handling of the material collected. For the value of the work done has been greatly impeded by a lack of the necessary resources, the damming up of the sources of knowledge seeming to many people the most obvious, and easiest, form of retrenchment when a demand for economy is being made.

The first Census of Production related to the year 1907, the results of the second Census relating to 1912 were never worked

up or published owing to the War, and the second effective census was not made until that relating to the year 1924. Owing to lack of staff the final and detailed results of this Census have not yet been published, although a further Census relating to the year 1930 is now in course of ascertainment.

The delay in publishing the results of the 1924 Census of Production has, indeed, been so serious that some of the results, when they are available, will be of comparatively little value except to the economic historian. The following comparison between this country and the United States may be of interest :—

	<i>Great Britain.</i>	<i>U.S.A.</i>
Census of Production relating to year.	1924	1927
First of preliminary reports ...	February, 1927	May, 1928
Conclusion of series of preliminary reports.	March, 1928	May, 1929
Final report	Only two volumes yet published (in June, 1930 and April, 1931).	April, 1930

It is also desirable that the scope of the Census of Production should be extended so as to yield similar and comparable information in regard to the distributive trades, of which no systematic statistical survey has ever been undertaken. This would probably require increased statutory powers to be given to the Board of Trade, as would be the case with a valuable minor extension of the Census of Production which should be considered, namely, the granting to the Board of Trade of powers to obtain from manufacturers details of the value of the principal materials used. This information is available, for instance, in the principal industries covered by the American and Canadian Censuses of Production, and lack of it makes many of the most important industrial statistics, relating to the dependence of one industry upon another, extremely chaotic.

We recommend that from 1932 onwards the Census of Production should be biennial or, if possible, annual, though a more completely comprehensive inquiry might be taken at quinquennial intervals as at present. The census of manufacture is now biennial in the United States and in the Dominions. Great advantages would accrue both to knowledge and to the difficult technique of carrying through these inquiries, if they could become a regular routine, instead of being spasmodic efforts at relating periods so far apart as to be, in the rapidly changing modern world, only partially comparable. It is indeed essential for sound judgment as to the trend of events that we should have accurate and up-to-date information as to the volume of the country's output and as to the change from year to year in the output per head of those

employed. We have found in the course of our inquiry that simple, fundamental facts of this kind, which ought to be securely known, are the subject of guess work and controversy about which nothing certain can be safely asserted.

10. THE VOLUME OF WAGES PAID.

419. In accordance with the recommendations of the Balfour Committee the Ministry of Labour in 1928 repeated the Census of Earnings which had been held in 1924. It is possible that this work may be repeated; and from these data, taken in conjunction with known figures of the number of insured workers in different industries, it is possible to make a good estimate of changes in the total "pay-roll" of manufacturing industry. But it would be desirable to extend the scope of these periodical inquiries into earnings. Outside manufacturing industry, the Ministry of Mines gives detailed figures of total earnings in coal mining and the Ministry of Transport gives annual figures of earnings on the railways. But for agriculture and for other forms of transport we have information relating only to time rates and not to average earnings; whilst for about a third of the whole national "pay-roll," represented by wholesale and retail distribution and domestic and personal services the only information available derives from one or two spasmodic special inquiries. In view also of the very large annual sum now paid in salaries (perhaps nearly half of the wage bill of some £1,600,000,000) it is very desirable that the Census of Earnings be extended, perhaps under the auspices of the Board of Inland Revenue, to cover the whole field of salaried workers, making it possible to obtain estimates of the total of salaries paid in various industries and services, and of changes from year to year.

11. THE VOLUME OF RETAIL SALES.

420. The Bank of England has recently undertaken the compilation of an index of retail sales based on returns from a number of the larger stores throughout the country. We think that these figures are valuable, and that their compilation should be continued and amplified as opportunity offers. Such an index with weights based on consumption at the present time rather than before the War would be of great value, particularly if it could be extended so as to give some estimate of a price index which would cover the whole field of consumption.

12. THE AGGREGATE AND THE DISTRIBUTION OF PROFITS.

421. At present we are dependent for our estimates of the profitability of business in general and of particular industries on the partial samples compiled, e.g., by *The Economist*, from the published accounts of public companies. In several respects these figures are an unreliable index of the position as a whole.

No published results in detail are available from the rich material at the disposal of the Board of Inland Revenue apart from certain special inquiries by Mr. W. H. Coates, which were published in the Appendices to the Colwyn Report on National Debt and Taxation. We strongly recommend that a fairly detailed survey of the profits of different industries and services relating to some recent year should be undertaken and published, and that thereafter the Board should use this comprehensive survey as base year and carry the figures forward annually by means of estimates so as to show year by year the movements of profits in British industry as a whole and in the main industries separately. When the figures are available over an extended period of time they should be a very useful indication of economic trend.

13. THE VALUE OF CAPITAL CONSTRUCTION.

422. Finally, we recommend that an attempt should be made to obtain early information, as accurate and comprehensive as the circumstances permit, of the value of contracts completed within the previous twelve months together with the value of contracts (as below) on hand still to be completed. These are statistics in which this country is at present particularly deficient. Yet they are of much importance to a Central Bank in determining whether and how far new capital construction needs from time to time to be encouraged or discouraged. It would probably be necessary to require that notification should be made to appropriate local authorities of all building and construction undertakings exceeding a certain minimum sum in value.

Virtually the whole field of capital construction would be covered if we could obtain full returns of the value of contracts from the following industries :—

- (1) building and contracting ;
- (2) engineering (including all branches, together with constructional engineering) ;
- (3) electrical trades ;
- (4) the heavy motor industry ;
- (5) shipbuilding.

Building plans have in all cases to be referred to the appropriate local authority. But full statistical returns are only obtained from certain cities and towns, in which for certain minor administrative reasons London is not included. There is, moreover, no machinery for recording those cases where the plans are not proceeded with and the figures for some years are in consequence of little value.

There is at present no machinery for recording capital construction under the other heads indicated above and even for the total money value of all production of capital which goes under these heads we have to rely on rather difficult estimates.

Except in the case of building and constructional work, returns of orders for capital goods (machinery, etc.) exceeding a certain

minimum sum in value could probably be best collected from the engineering firms and others which manufacture the capital goods. A similar statement would be required from importers and dealers.

14. CO-ORDINATION OF STATISTICAL WORK OF DIFFERENT DEPARTMENTS.

423. At various points above reference has been made to the necessity for maintaining the proper comparability between different industrial statistics. The four Government Departments principally responsible for industrial statistics—the Registrar-General, the Board of Trade, the Inland Revenue and the Ministry of Labour—use, at present, three quite different industrial classifications. The figures of the Ministry of Labour, although this classification is now in line with that of the Census, are not fully comparable since they refer to insured workers only. Over the greater part of the industrial field it is impossible to make comparisons between the Census of Production on the one hand and the Census of Population or the Ministry of Labour figures on the other hand. Again the Earnings and Hours Inquiries of the Ministry of Labour use a classification which is similar to (although not identical with) that of the Census of Production, but which is different from the classification of their figures of employment and unemployment. In general, the most detailed and careful comparison of these various figures does not enable the investigator to make use of any industrial figures except for a few broad groups of industries. Doubtless these anomalies have grown up for reasons of administrative convenience. But for statistical and economic purposes much of their value is thus lost.

A similar difficulty prevails in regard to statistics compiled on a regional basis. It is desirable that, as far as possible, all these statistics should be on a plane of comparability.

424. It is probable that the bulk of these statistics could be obtained with the voluntary co-operation of those concerned. Nevertheless the value of statistical returns can be greatly impaired by the recalcitrancy of a few of those from whom figures are required. In any case in which the departments concerned consider that they would need a power to require information if the statistics are to be sufficiently comprehensive, we recommend that they should be given such power unless in any particular case there seems to be especial reason to the contrary. The practical value of the statistics, the regular collection and prompt publication of which we recommend, will increase considerably in course of time after a fairly long series of figures are available for purposes of comparison.

425. We attach very great importance to this part of our recommendations being carried into effect. For the completer information, which would thus be put at the disposal of those responsible for deciding policy, may prove to be an indispensable preliminary to their being able to work out practical methods of management for attaining the objectives of the monetary system. To put on a more scientific basis our acquaintance with the fundamental facts and trends of our economic life, and to replace empiricism by ordered knowledge, might prove to be the greatest step forward that it lies within our power to take towards raising the economic well-being of our country to the level which the technique of production would allow, provided only that our machinery for collective action was such as to facilitate the whole of our productive resources being brought into fruitful activity.

CONCLUDING NOTE.

426. We have now completed all the recommendations which we are able to make for remedial action by the monetary machine itself. If our recommendations relating to international action are given effect, we should hope for a great improvement in the situation in due course. If, however, progress along these lines is delayed or if the action taken is insufficient, we believe that our own monetary authorities will not be able to remedy matters without assistance from changes in other non-monetary factors by which the volume of our domestic output and employment, and in particular our balance of trade, are also much influenced.

427. Thus it is of the greatest importance that other domestic action, not of a strictly monetary character, should be taken as an essential condition to the monetary authority being in a position to employ effectively the methods of monetary policy. But when we came to consider the various alternatives which have been put before us for domestic action of this character, we found considerable difficulty in deciding just how far our terms of reference extend and where to draw the line between matters lying within them and those lying beyond. It has been a further difficulty that some of these alternatives raise matters of active political controversy and cover ground where a general agreement among the members of this Committee was scarcely to be expected.

428. In face of these difficulties some of us have felt that there is nothing which, in our capacity as members of this Committee and within our terms of reference, we can usefully add to the foregoing chapters. Other members of the Committee, however, have felt that some further exploration of the problem, even though it leads into non-monetary ground, is part and parcel of their view of the monetary situation as a whole. We have thought it best,

therefore, to give as Addenda* to this Report certain memoranda which set forth the views of those of our members who feel that our Report would be incomplete without further explanations and proposals.

We have the honour to be,

My Lords,

Your obedient Servants,

MACMILLAN, *Chairman.*

THOS. ALLEN.†

ERNEST BEVIN.†

R. H. BRAND.

T. E. GREGORY.

J. M. KEYNES.

L. B. LEE.

CECIL LUBBOCK.‡

R. MCKENNA.

J. T. WALTON NEWBOLD.§

WALTER RAINE.||

J. FRATER TAYLOR.

A. A. G. TULLOCH.

G. ISMAY, *Secretary,*

23rd June, 1931.

* The Addenda are as follows :—

I. By Sir Thomas Allen, Mr. Bevin, Mr. Keynes, Mr. McKenna, Mr. Frater Taylor and Mr. Tulloch (see page 190), subject in the case of Sir Thomas Allen and Mr. Bevin to a joint reservation (see page 209).

II. By Mr. Brand (see page 210).

III. By Professor Gregory (see page 217).

IV. By Mr. Lee (see page 237).

† Subject to the Reservation on page 239.

‡ Subject to the Reservation on page 241.

§ Subject to the Reservation on page 241.

|| Subject to the Reservation on page 257.

Alphabetical List of Witnesses.

<i>Name of Witness.</i>	<i>Bodies represented.</i>
Bellarby, Mr. J. R.	—
Berkeley, Mr. Edward	National Union of Manufacturers (joint evidence).
Bolton, Mr. W. H.	Economic Freedom League (joint evidence).
Bowley, Professor A. L.	—
Catterall, Mr. W. H.	Federation of Master Cotton Spinners' Associations, Ltd. (joint evidence).
Clark, Mr. Colin G.	—
Clay, Professor Henry	—
Courthope, Colonel Sir George L., Bart., M.C., M.P.	Central Landowners' Association (joint evidence).
Dampier-Whetham, Mr. C., F.R.S.	Central Landowners' Association (joint evidence).
Davies, Mr. T. G.	Joint Parliament Committee of the Co-operative Congress (joint evidence).
Douglas, Major Clifford Hugh, M.I.Mech.E., M.I.E.E.	—
Driver, Mr. T.	Federation of Master Cotton Spin- ners' Associations, Ltd. (joint evidence).
Foà, Mr. R. H.	—
Glenday, Mr. R. G.	Federation of British Industries (joint evidence).
Goldenweiser, Mr. E. A.	—
Goldschmidt, Dr. Jakob (accom- panied by Mr. H. Powys Green- wood).	—
Goodenough, Mr. Frederick Crau- furd	Barclays Bank Limited.
Goschen, Sir W. H. N., Bart., K.B.E.	National Provincial Bank Limited.
Granet, Sir W. Guy, G.B.E.	—
Hall, Professor F.	Joint Parliament Committee of the Co-operative Congress (joint evidence).
Hammersley, Mr. S. S., M.P.	Federation of Master Cotton Spin- ners' Association, Ltd. (joint evidence).
Harvey, Sir Ernest Musgrave, K.B.E.	Bank of England.
Hawtrej, Mr. R. G.	—
Hichens, Mr. W. L.	—
Holroyd, Mr. F., J.P.	Federation of Master Cotton Spin- ners' Associations, Ltd. (joint evidence).
Hopkins, Sir Richard V. N., K.C.B.	H.M. Treasury.
Howson, Mr. R. A.	Joint Parliament Committee of the Co-operative Congress (joint evidence).
Hyde, Mr. Frederick	Midland Bank Limited.
Jenkinson, Sir Mark Webster, K.B.E., F.C.A.	—

<i>Name of Witness.</i>	<i>Bodies represented.</i>
Kinderaley, Sir Robert M., G.B.E.	—
Kitchin, Mr. Joseph	—
Kitson, Mr. Arthur	Economic Freedom League (joint evidence).
Lakin-Smith, Mr. H., F.C.A. ...	Association of British Chambers of Commerce.
Lithgow, Lieutenant-Colonel Sir James, Bart., M.C.	Federation of British Industries (joint evidence).
Milne-Bailey, Mr. W.	Trades Union Congress General Council (joint evidence).
Niemeyer, Sir Otto E., G.B.E., K.C.B.	—
Norman, The Right Hon. Montagu Collet, D.S.O.	Bank of England.
Nugent, Sir Roland	Federation of British Industries (joint evidence).
Payton, Mr. E. L.	National Union of Manufacturers (joint evidence).
Pease, Mr. J. W. Beaumont ...	Lloyds Bank Limited.
Peddie, Mr. J. Taylor	Federation of Master Cotton Spinners' Associations, Ltd. (joint evidence).
Perring, Sir William, J.P. ...	National Chamber of Trade.
Pigou, Professor A. C.	—
Pogson, Mr. John	Federation of Master Cotton Spinners' Associations, Ltd. (joint evidence).
Pugh, Mr. Arthur	Trades Union Congress General Council (joint evidence).
Rae, Mr. John	Westminster Bank Limited.
Robertson, Mr. D. H.	—
Scott, Mr. George J.	Scottish Banks (joint evidence).
Simm, Mr. F.	Federation of Master Cotton Spinners' Associations, Ltd. (joint evidence).
Sprague, Dr. O. M. W.	—
Stamp, Sir Josiah C., G.B.E. ...	—
Stewart, Dr. W. W.	—
Strakosch, Sir Henry, G.B.E. ...	—
Wiggins, Mr. W. M., J.P.	Federation of Master Cotton Spinners' Associations, Ltd. (joint evidence).
Wise, Mr. E. F., C.B., M.P. ...	Independent Labour Party.
Woodburn, Mr. Arthur	National Council of Labour Colleges.
Wright, Sir Alexander K., K.B.E., D.L.	Scottish Banks (joint evidence).

Memoranda, etc., were furnished by the following, among others:—

Agricultural and Industrial Union.
 Anglo-South American Bank, Limited.
 Association of Engineering and Shipbuilding Draughtsmen.
 Birmingham Trades Council.
 Fabian Society.
 Industrial Institute.
 International Fixed Calendar League.
 League of Science.
 London Commercial Club (certain Members of).
 Manchester Association of Importers and Exporters.
 Manchester Economic Research Association.
 Monetary Reform Association.
 National Federation of Iron and Steel Manufacturers.
 National Gas Council.
 West Ham Borough Council.

Mr. J. Adamson.	Mr. P. W. Martin.
Mr. A. Linney Arnold.	Mr. Arthur G. Marshall.
Mr. Edward Batten, M.I.Mech.E.	Lieutenant-Colonel D. W. Maxwell.
Mr. C. E. Cope.	Mr. Henry Meulen.
Mr. J. F. Darling, C.B.E.	Mr. George H. Milner.
Mr. W. R. Darwin.	Mr. C. L. Nordon.
Mr. W. M. Dimpleby.	Mr. Ivan Pedersen.
Mr. W. J. Duggan.	Mr. Charles Edward Pell.
Commander P. Harrington Edwards.	Sir John Pilter.
Mons. J. Gersony.	Mr. Joseph Ricardo.
Mr. J. W. Greenwood, M.B.	Professor J. W. Scott.
Mr. M. Jones.	Sir Oswald Stoll.
Mr. Percy H. Joseph.	Mr. J. E. Tuke (and others).
Mr. Stephen J. Lett.	Mr. W. H. Wakinshaw.
Mr. A. H. Mackmurdo.	Mr. W. A. Welshman.
	Mr. F. Wigglesworth.

ADDENDUM I.

Proposals relating to Domestic Monetary Policy to meet the present emergency.

1. We have signed the Report of the Committee without reservation.* But in our opinion it is incomplete without certain further observations. Rightly or wrongly, we conceive it our duty to consider possible methods of increasing the ability of the banking system to put into effective operation the principles of action which we have recommended above. For if the situation remains unchanged in other respects, we doubt whether it lies within the power of the banking system to restore employment to a satisfactory level.

THE EXPANSION OF CREDIT FOR DOMESTIC PURPOSES.

2. The upshot of the preceding chapters may be summarised as follows. For the world as a whole the best hope of a remedy lies in a monetary policy designed to increase the volume of purchasing power, to increase the ease of borrowing if necessary by guarantees, to diminish the rate of interest long-term as well as short-term, and to stimulate in every possible way the spirit of enterprise and the volume of investment.

3. If Great Britain were, like the world, a closed system, the same monetary remedies would be equally applicable here. But unfortunately this is less true of us than of any other country. Our economic affairs are intricately bound up with an international system. Consequently the power of the Bank of England to initiate an independent policy, irrespective of what is going on abroad, is strictly limited.

4. Whether it is as limited as—to judge from its policy over recent years—the Bank of England has believed, is open to debate. Mr. Hawtrey has expressed in evidence most forcible and interesting views to the contrary. He urges that the power of the Bank to influence the rest of the world, and to refuse to be led by it, whilst not what it was before the War, is nevertheless great. He contends that the amount of foreign balances, which we run the risk of losing if we make money relatively cheap in London, is not so large as is commonly supposed. Whatever may have been true a little time back, we are not prepared to accept Mr. Hawtrey's views as fully applicable to the present very abnormal circumstances, where confidence is liable to be disturbed; and it would, we think, be asking too much to expect the Bank of England to make an experiment of uncertain outcome in the existing environ-

* Except in the case of Sir T. Allen and Mr. Bevin.

ment. It is its duty to put absolute safety first. At the same time there may be much more force in Mr. Hawtrey's general line of argument than is usually admitted. We do not believe that the position abroad need always prevent the Bank of England from furnishing additional credit, provided there is a real opening for its employment in increased domestic enterprise. It would be unsafe for the Bank to increase materially the total volume of credit without considering how it will be employed. But this should not be urged as an argument applicable to cases where there is a reasonable prospect of the new money finding its way into domestic enterprise.

5. Moreover the risks of expanding credit would be much diminished if the Bank of England would take the clearing banks more into its confidence, in the way in which it has traditionally confided in the leading accepting houses, and invite their co-operation. We desire to state this conclusion with some emphasis. While the quantity of money is controlled by the Bank of England, the way in which additional supplies are used can be largely directed by the clearing banks, and co-operation between these banks and the Bank of England is essential. The Committee as a whole have recommended in para. 372 that this should be done. If this recommendation is acted upon, so that the clearing banks on their side can make it clear when they are in a position to direct additional credit into domestic channels and when they are not, and the Bank of England on its side can tell the clearing banks when an expansion or contraction of credit is intended to have its natural repercussions on the foreign short-term loan position and when it is not, it will be much easier than it is now to ensure that domestic enterprise and investment of whatever kind shall never be starved of the accommodation which it requires. In spite of some evidence to the contrary which has been offered to us, we are not convinced that this has invariably been the case in recent years.

6. To-day, however, the main trouble is not a limitation on the amount of available bank credit, but the reluctance of acceptable borrowers to come forward. Thus the first step must probably be some kind of direct stimulus, for example, a considerable fall in the long-term rate of interest payable by typical borrowers, or some kind of State action. Either of these conditions here, without corresponding conditions elsewhere, can scarcely avoid putting some strain on the international position of the Bank of England. To meet this strain a strengthening of the country's surplus on the balance of trade is required. It is also true that the Bank would be in a better position to exercise its full moral influence internationally if its power to retain its gold was beyond question.

7. Thus we are led inevitably to consider whether any other measures are practicable which would restore or increase the Bank

of England's ability to employ its monetary power in a constructive way—though some of these measures may seem to lead us away from monetary policy proper.

AN ANALYSIS OF THE ALTERNATIVES.

8. We know no way in which the initial impetus to increased employment can be given except by (i) an increase of exports, (ii) the substitution of home-produced goods for goods now imported, or (iii) an increase of investment at home—though once the vicious circle can be broken in any of these ways the increased purchasing power of the men put back into work will further increase employment in supplying their needs.

9. This may be put quite shortly by saying that we must either increase our favourable balance of international payments, or find an outlet for more of our savings at home, or, better still, do both. Indeed the whole problem may be made to centre round the balance of trade.* We can increase our surplus by exporting more or importing less. We can export more only if world trade revives, or if we reduce our gold-costs faster than our competitors reduce theirs, or if we give the export industries some kind of special advantages. Similarly we can import less only by a relative reduction of our own costs or by some restriction on imports. Finally we can only find employment for more of our savings at home by increasing the enterprise of borrowers or by somehow subsidising the cost of borrowing.

10. In practice, therefore—putting on one side the increase of our efficiency relatively to that of our foreign competitors, the desirability of which, if we can do it, is obvious and common ground between all parties—the practical courses open to us come down to three:—

- (i) A reduction of salaries and wages;
- (ii) Control of imports and aids to the export industries;
- (iii) Domestic enterprise assisted by State action, or subsidies to private investment at home.

* For the amount of international surplus which we currently need for net foreign lending depends on how much of our saving is trying to find an outlet abroad. The greater the amount which finds an outlet at home, the smaller the international surplus which we require in order to be in equilibrium. Thus to restore our position and to make full employment possible, we require both to increase our surplus on the balance of trade and also to find increased outlets for our savings at home. When the excess of our total savings over that part of them which we can employ at home is equal to our surplus on the balance of trade, there need be no monetary obstacle to the full and profitable employment of all our resources of men and plant. This analysis enables us to narrow down the alternatives.

There is probably no serious dispute as to all these courses, considered apart from their social and long-period consequences, having *some* effect in the right direction. The difference between us and those who emphasise the importance of the first might be expressed by saying that they feel on a balance of considerations that there is not enough to be hoped for in practice from a cautious application of (ii) and (iii) and that there is great danger in losing sight of (i), which is more fundamental in their judgment and in the long run "sunder"; whereas we feel exactly the opposite, namely, that the practical results of an attempt to reduce salaries and wages are likely to be exceedingly disappointing. They feel that it might be dangerous to divert the public mind from what they believe to be the ultimate necessity of (i) by offering remedies under (ii) and (iii) which may prove specious; whereas we believe that nothing is more likely to produce stale-mate than to concentrate public attention on (i).

11. We now proceed to consider in turn the three courses open to us. The first and the second, let us repeat, would benefit the situation primarily by increasing our foreign investment and by enlarging the power of the Bank of England to pursue without embarrassment a policy of stimulating enterprise both at home and abroad; while the object of the third would be to increase home investment by methods which did not run the risk of unduly increasing at the same time the tendency to lend abroad more than our foreign trade surplus can support.

I.—A REDUCTION OF SALARIES AND WAGES.

1. THE NEED FOR SOME ELASTICITY OF MONEY-INCOMES.

12. Certain preliminary observations are here necessary for the avoidance of misunderstanding. So long as the standard of value is subject to wide fluctuations in terms of consumable commodities, it is essential that there shall be a reasonable elasticity and mobility in the level of the money-incomes which workers and others are ready to accept as equitable. If money-incomes have been established at a level appropriate to a certain purchasing power of money and if purchasing power then undergoes a large increase, the fortuitous advantage which will then accrue to those whose money-incomes are unchanged may be quite inappropriate to the new situation and without substantial justification. Great evils must needs result, and have resulted, from the excessive rigidity of various types of money-income in such circumstances. This is just as true of the rigidity of rentiers' incomes as it is of the rigidity of wage-earners' incomes. We think, therefore, that it would be quite wrong to regard the level of money-incomes, with which we happen to find ourselves at any time, as sacrosanct.

13. For example, the cost of living, as measured by the Ministry of Labour index number, has fallen 18 per cent. since 1925 and 12 per cent. since the beginning of 1929. In so far as this is due to increased productivity, or to a movement of the terms of foreign trade in favour of this country (so that our exports are exchanged per unit for a larger quantity of imports than before), it is arguable that these advantages should be enjoyed by recipients of money-incomes in the shape of increased purchasing power. But in so far as it is due to a change in the value of money for other reasons, an attempt to retain the fortuitous advantages thus accruing will involve an unjustifiable transference at the expense of the entrepreneur, which must seriously disturb the efficient working of the economic machine and be the cause of unemployment. It may be, therefore, that some downward adjustments in the quantity or value of money-incomes of every kind are called for on these grounds so long as the present low level of general prices continues. A readiness to accept the fact that the value of incomes is something which must be accommodated to changing circumstances is, indeed, an essential condition of the sound working of our economic system.

2. REDUCTIONS OF SALARIES AND WAGES AS A REMEDY FOR THE INTERNATIONAL SLUMP.

14. A primary reliance on reductions of salaries and wages as a means of restoring employment and of recovering our international equilibrium might, however, require much more drastic action than can be easily justified, or is likely to be accepted, merely on the grounds just given. It is impossible to calculate in advance what increase of employment could be expected from a given average reduction of wages. But the relation of the one to the other might disappoint the expectations of many people, inasmuch as a false analogy is often drawn from the obvious great advantages to an individual employer of a reduction of the wages which he has to pay. For each employer perceives quite clearly the advantages he would gain if the wages which he himself pays were to be reduced, but not so clearly the disadvantages he will suffer if the money-incomes of his customers are reduced. Just as it is to the advantage of each producer that every product should be cheap except his own, similarly it is to his advantage that all costs and wages should be high except those which he himself incurs—since the demand for his product comes from the incomes which are paid out as costs by other producers.

15. On the other hand, a reduction of the costs of British manufacturers as a whole which is not associated with an equal reduction of the incomes of their customers, plainly benefits them. So does a reduction of costs which brings them new customers. The first applies to those of them who manufacture for export,

and the second to those of them whose products, if they were cheaper, might be substituted for goods now imported. But this assumes that a reduction of costs here does not provoke a corresponding reduction by our foreign competitors. For just as a reduction of his costs only helps a domestic manufacturer if it applies to him alone and not to all his neighbours, so internationally a reduction of costs only helps British manufacturers if it applies to them alone and not to the whole world.

16. Thus there are two subtractions which it is necessary to make from the *prima facie* advantages of general wage reductions. In the first place many purely domestic industries will only obtain secondary advantages, since what they gain in reduced costs will be offset by the diminished purchasing power of their customers; so that the greater part of the primary advantages of wage reductions would be concentrated in the foreign trade industries, i.e., those which work for export or compete with imports. In the second place, even in the foreign trade industries we cannot be certain in advance that wage reductions here will not be countered by corresponding cuts on the part of our chief competitors.

17. It might be, therefore, that an attempt to remedy unemployment by general wage reductions would require very large reductions. As an illustration, an average reduction of money wages by 10 per cent. would, since it would reduce total costs by much less than 10 per cent., have much less effect on our foreign trade than a tariff of 10 per cent. on all imports and a subsidy of 10 per cent. on all exports. Yet it would be optimistic to expect even from the latter more than a partial remedy. The same conclusion follows from a comparison between the wages paid here and those paid by our chief continental competitors.

18. If the position had to be met by an average reduction of money wages only throughout all industries sufficient by itself to restore our foreign trade to an equilibrium position, it might have to be, in present conditions, as great as 20 to 30 per cent., though any such estimate must necessarily be liable to a wide margin of error. The corresponding reduction of real wages would not, of course, be nearly so great as this, inasmuch as there would be a substantial fall in the costs of home products and services. Nevertheless an attempt to secure any such reduction might be expected to produce social chaos and react most unfavourably on trade generally.

19. These considerations are far from intended to lead up to the conclusion that the remedy of reducing money-costs in terms of gold is one which can be avoided in all circumstances. But they emphasise the grave difficulties of an approach to the problem along these lines, and they raise a doubt as to whether reductions of salaries and wages are the right way of dealing with the existing

international slump. It is not easy to see how we can expect a revival in our foreign trade, on a sufficient scale to be of much value to us, by any other means than through a revival of world demand. To meet the immediate problems, arising out of the world slump, a policy intended to direct increased purchasing power into the right channels, both at home and abroad, with a view to restoring equilibrium at the *present* level of costs, would, therefore, be much wiser, in our judgment, than a policy of trying to cut our costs faster than the rest of the world can cut theirs.

3. THE ULTIMATE LEVEL OF SALARIES AND WAGES.

20. Nevertheless, it is quite possible that, when the international slump is, in the maturity of time, righting itself, we shall continue to find ourselves faced with difficulties due to our money-costs being still too high relatively to our neighbours. For in the long run we cannot support a level of money-costs in terms of gold which is out of equilibrium with similar costs elsewhere—and this is true quite independently of our adherence to the gold standard. This, perhaps, is the fundamental reason why some would think it wise to begin at once to take steps to bring down our costs, not necessarily to the level which would be required to restore our foreign trade in slump conditions, but at least to the level which may be required to put us on equal terms with our chief competitors when the slump conditions are ended. We must, therefore, endeavour to express our views on this issue as clearly as we can.

21. There are two distinct questions on which we have to form a judgment. First, what is the likelihood that the existing level of money wages will be beyond our capacity when the violence of the present Credit Cycle will have spent itself? Secondly, if in the event it does prove necessary to reduce the prevailing level of money-incomes, should the reduction be a *general* one applicable to all classes of income, and by what means should it be brought about?

22. It is obvious that it is much too soon to attempt an answer to the first question. It depends on the level at which money-costs expressed in terms of gold settle down in the countries which buy our goods or compete with us in producing them. This in turn depends on the success of the efforts recommended in the Report of the Committee for raising the international price level by increasing, through investment and otherwise, the effective volume of purchasing power throughout the world. It also depends on the time which will elapse before any success attends on these efforts and on the duration of the slump. For the longer the slump lasts, the more probable it is that country after country will feel itself compelled to resort to competition in wage-cutting.

This will be a counsel of despair, especially for debtor countries, since universal wage-cutting will help no one and will merely serve to rivet on the shoulders of the debtors a heavier burden of monetary obligation. But in the downward race anyone who can get a little ahead of his neighbours will snatch a temporary advantage, and no one can afford to lag far behind under penalty of losing all his trade. For this reason we may be compelled to follow suit. Nevertheless we should not take the lead in what is so contrary to the common interest, and we should be as reluctant as our circumstances permit to press closely behind those who are leading the way in this direction.

23. If remedial measures are delayed, the pressure towards wage reductions in the rest of the world may prove overwhelming. If so, we must grapple the problem firmly on lines to be considered below. The position may change quickly. But the available statistics have not convinced us that it is, as yet, either necessary or desirable to engage in competitive wage-cutting.

24. The matter may also be looked at from another angle. Apart from competitive considerations, does the present level of wages represent an unreasonable, and in the long run an impracticable, demand on the part of labour for too large a share of the joint product of industry? No doubt, almost everyone in a country such as Great Britain is gaining advantages in the purchasing power of his income through the exceedingly low relative prices of many articles of food, which he cannot expect to retain when the international slump is over. But this is not a peculiarity of wages—it applies equally to every class of income in a country which is temporarily in a position to import large quantities of goods at distress prices. We have, therefore, postulated some rise of international prices as a necessary condition of the maintenance of the present level of British money-incomes. The question whether the British worker is receiving too large a share of the British national dividend as compared with the other classes of the community is another matter. It is not proved, in our opinion, that wages have been recently a much larger proportion than formerly of the total value of the product—at any rate not up to 1929. The available statistics suggest that there has been a remarkable degree of stability in the proportionate division of the produce (see evidence, 47th day). Moreover there is another consideration which impresses us. If we can pay for present standards both for the employed and for the unemployed, and at the same time add to our capital wealth (as we believe to be even still the case), with nearly a quarter of our industrial resources idle, does not this suggest that we should have a comfortable margin over if we could manage to bring back into activity the whole of our resources—even after allowing substantially for the loss of our present temporary advantage from the unduly low prices of our imports?

25. Thus the problem seen in this light is one of disequilibrium rather than of excessively high standards; and the task upon which we should concentrate is that of remedying the disequilibrium so as to bring our productive resources into full play, rather than of attempting to lower standards.

4. MEANS OF ADJUSTING MONEY-INCOMES.

26. Whatever efforts we may make and however high the hopes we entertain, it remains true, unfortunately, that our efforts and hopes may be defeated. It would be absurd to maintain that we can continue to adhere to the existing level of money-incomes irrespective of the value of money. We have, therefore, to consider what measures we should recommend if an adjustment of money-incomes becomes plainly unavoidable.

27. We are here considering, not normal wage-adjustments of the kind which we have discussed at the commencement of this section, but a substantial general change, amounting to (say) 10 per cent. or more, in the level of money-costs and incomes, designed to remedy a position of national disequilibrium due to a change in the value of money.

28. We consider that a change of this character cannot, with equity, be concentrated on salaries and wages, but should apply to every category of income alike, including those protected by contract. The benefit of an increased value of money is just as fortuitous in the case of the *rentier* as in the case of the wage-earner, and the burden on enterprise and on the Budget of having to pay the same amount of money as before to meet interest charges, though the value of money is greater, is similar in character to the burden of having to pay the same money wages as before. Moreover a great social change of this kind cannot be carried through except by general consent.

29. This view is reinforced by a consideration of the monetary history of recent years. A large part of the National Debt was incurred at a price level much higher than that which now prevails. The long period of deflation which culminated in the return to gold at the pre-war parity had the effect of increasing the burden of this Debt. The fall in world prices which has occurred more recently has caused a large further aggravation of the burden. In view of the fact that the increase in the value of sterling was deliberately intended, it seems difficult to require a reduction of salaries and wages without proposing any modification of the uncovenanted blessings which accrued to the holders of the National Debt and of claims on money generally and to other classes whose incomes have remained unaffected.

30. Our conclusion is, therefore, that if a substantial change should become necessary, it must be a *general* change and apply, so far as possible, to every class of income alike.

31. If this conclusion be accepted, it follows that it cannot be left to natural economic forces to bring it about by the mere pressure of events. For this would certainly not result in an equal all-round change. In Chapter XI the Committee have explained that the pressure which can be brought to bear on the economic system by a restriction of credit, whilst suitable for the purpose of effecting the comparatively small adjustments of ordinary times, is not an appropriate means for effecting large changes. Yet, in effect, it is upon this method that we have been relying hitherto. The rate of long-term interest and the volume of credit are maintained at levels which are deterrent to investment, and the unemployment which ensues is, under a *laissez-faire* system, the natural form of pressure to secure a reduction of wages. What alternative means are open to us for an orderly contraction in terms of gold of money-incomes in general?

(a) *Devaluation.*

32. Theoretically the most obvious and comprehensive method of effecting the desired object would be to leave money-incomes alone but to change the monetary standard, e.g., by diminishing by 10 per cent. the gold parity of sterling. This would have the advantage of bringing the direct, initial benefit to those industries which need it most, namely, to the foreign-trade industries. It would involve no interference with contract, since debts are legally fixed in terms of sterling and not in terms of gold. It would affect every class of income without the necessity of any other special measures. For a country which was not an international banker and was not owed large sums from abroad fixed in terms of sterling, this would be the simplest solution.

33. We have already agreed, however, that for a country in the special circumstances of Great Britain the disadvantages would greatly outweigh the advantages, and we have concurred with our colleagues in rejecting it.

(b) *Tariffs plus Bounties.*

34. Precisely the same effects as those produced by a devaluation of sterling by a given percentage could be brought about by a tariff of the same percentage on all imports together with an equal subsidy on all exports, except that this measure would leave sterling international obligations unchanged in terms of gold. This proposal would avoid the injury to the national credit and to our receipts from foreign loans fixed in terms of sterling which would ensue on devaluation.

35. Under existing commercial treaties, however, there would be practical difficulties in the way of a direct subsidy to exports. Nevertheless, various plans might be propounded for combining

some form of restriction of imports with granting sundry indirect advantages to the export industries, which would represent an approximation to the above scheme. We consider that a plan of this kind would be so immeasurably preferable to devaluation, that it is foolish even to discuss the latter while the former remains untried.

36. It is worth while to remark that, if the level of domestic money-incomes is such that our international equilibrium would be restored by a reduction of money-incomes or by the devaluation of sterling, then it follows that, failing the adoption of one or other of these two expedients, the optimum distribution of the national resources between different uses will result, not from Free Trade, but from as near an approximation as is practicable to a *Tariff plus Bounties* measure on the above lines.

37. The avowed object of such a measure as this would be to reduce the value of a given money-income; though the cost of living might be expected to rise by only a fraction of the percentage rate of duty. Its advantages would be two. In the first place it would be fair; for every description of money-income would be affected equally. In the second place, it would involve no disturbance to confidence and no breach of understanding with our foreign creditors.

(c) *A National Treaty.*

38. There remains the project of a national agreement for the general and simultaneous adjustment of *all money-incomes* by a tax on incomes which, for one reason or another, are exempt from the general cut, and an adjustment of all salaries and wages and other money-incomes not protected by contract. There would, inevitably, be great practical difficulties in the way of a re-settlement of this kind, and we cannot say how far they could be overcome without giving more examination to the details of some such scheme than it has been possible for us to give. But in the last resort it is at least theoretically conceivable that by means of a National Treaty, on some such lines as this, an escape from our currency difficulties could be found.

II.—CONTROL OF IMPORTS AND AIDS TO EXPORTS.

39. Proposals under this heading raise political and social issues which extend far beyond the necessities of the present emergency. A specific may be appropriate to a particular situation, and yet be rejected in obedience to wider considerations more extended in time. We do not propose to attempt any such summing up of the final balance of advantage and disadvantage, having regard to all the relevant factors, as would be needed to justify a definite recommendation. We shall confine ourselves, therefore, to considering briefly the uses of tariffs or Import Boards, etc., and subsidies on

articles of foreign trade regarded as an expedient to meet a situation in which a country has a large unemployed surplus of labour and of plant which it is unable to bring into use in the conditions imposed on it by its economic relations, arising out of relative rates of interest and money-costs, with the rest of the world.

40. The fundamental argument for unrestricted Free Trade does not apply without qualification to an economic system which, neither in equilibrium nor in sight of equilibrium. For if a country's productive resources are normally fully employed, a tariff cannot increase output, but can only divert production from one direction into another, whilst there is a general presumption that the natural direction for the employment of resources, which they can reach on their merits and without being given special advantages at the expense of others, will yield a superior national dividend. But if this condition of full employment is neither fulfilled nor likely to be fulfilled for some time, then the position is totally different, since a tariff may bring about a net increase of production and not merely a diversion.

41. It appears to us, therefore, that, if imports were to be controlled, whether by a tariff with compensation for exports, or by Import Boards, or in some other way and home-produced goods substituted for them, there is a presumption, so long as present circumstances last, that this would mean a net increase of employment and of national productivity. Into the rate of the tariff and the classes of the articles affected we do not enter.

42. The arguments most commonly adduced on the other side—apart from long-period considerations which we are not pretending to discuss—are the following:—

(i) It is said that the restriction of certain kinds of imports would curtail foreign buying power and so diminish the market for our exports. This would be true if we were to use our improved balance of trade to import gold and the consequent loss of gold by the rest of the world had the effect of causing a contraction of total credit. But if we make use of our improved balance of trade to expand investment at home with the result of increasing our imports of food and raw materials (an expansion which would have led to a *loss* of gold by us if we had attempted it without a contemporaneous restriction of imports) or to increase our foreign lending, then it need have no adverse effect on the market for our exports.

(ii) It is said that a restriction of imports would tend to increase the cost of production of our exports. This is a question of degree depending on the kind of restriction imposed. Clearly a substantial tax on imported raw materials without a rebate for exports would have a seriously adverse effect on exports. At the other extreme, it is not evident that a tax on the importation of luxury motor cars or an Import Board for pig products would have any

appreciable consequences of this kind. It is easy to conceive both of a tariff, accompanied by appropriate rebates, and of Import Boards the effect of which on the cost of exports would be small compared with that of other factors. Nor is there any reason to suppose that the effect on exports need be commensurate with the effect on imports.

Nevertheless, even if these measures were so devised as to impose only a small handicap on our exports, this would be *pro tanto* an objection. The logical course, in our opinion, would be to find ways of giving equivalent advantages to the export industries. For much of the argument in favour of a restriction of imports applies equally to a subsidy to exports. A direct subsidy would be open to various practical objections. But it would not be difficult to find other ways of giving back to the export industries advantages at least equal in amount to the comparatively small disadvantages which would be imposed on them by those effects of restricting imports by a tariff or otherwise which would be individually too small and incalculable to be dealt with by means of a rebate.

(iii) The third objection, which is most commonly heard, relates to the effect on the cost of living of the working classes. The force of this objection depends partly on the character of the tariff or other measures in view, and partly on a comparison with the effect on the cost of living of those measures to which the tariff is offered as an alternative.

For example, a given amount of revenue raised by taxing manufactured imports would probably increase the cost of living less than if it were raised by taxes on tea, sugar, beer and tobacco. Or again, if it were to diminish the necessity to reduce wages or had the effect of increasing employment at the existing wage, its effect on working-class standards would probably be favourable. We think that a scheme could be devised which would have no adverse effects on working-class standards.

43. Since many of the arguments in favour of a restriction of imports apply equally in favour of schemes of assistance to exports, some system of restricting imports, accompanied by a policy of giving advantages to the export industries, would seem to be the most practical plan of action.

44. Finally, the immediate effect of such measures in reviving business confidence and a spirit of enterprise scarcely needs to be emphasised.

45. For these reasons and also because relief would be given both to the Budget and to the balance of trade, it would seem that restrictions on imports and aids to exports would run well in double harness with the other class of remedy which we next discuss, namely, schemes of capital development. For it is obvious that the whole of the resources required for capital development at home are necessarily found within the country and as a

result of our own efforts and sacrifices, except in so far as their effect is to diminish our net foreign surplus, whether by decreasing our exports or increasing our imports. Thus the "burden" of such schemes, for which we need to make special provision is exactly measured by the burden on the balance of trade. If, therefore, we were to expand investment at home *and* control imports, we should get the favourable effects of both schemes on domestic employment and avoid the disturbing effects of both on our international balance.

III.—SCHEMES OF CAPITAL DEVELOPMENT.

46. We see no reason to doubt that new capital investment at home would, in present circumstances, create additional employment—subject only to the qualifications explained below. So far from this additional employment being less than appears at first sight, it is likely to be considerably more. For in addition to the men directly employed and to the men occupied in making and transporting the materials required, there will be a further set of men put into work to supply the needs created by the additional purchasing and consuming power of the first set of men, and so on.

47. The objections which have been advanced against an unqualified acceptance of this conclusion are the following:—

(i) It has been argued that it is not possible to ensure that any particular scheme of investment will mean *additional* expenditure. It may merely cause a diversion of finance and of resources from different expenditure which would have occurred otherwise. If the national productive resources were fully occupied, this might be the case. Or if the banking system were to limit the volume of credit in a certain way, it might be the case. But in present circumstances, when the physical limit on further capital output is far from reached, there is no reason why the action of the banking system need stand in the way of additional investment, unless this investment was throwing too heavy a burden on the balance of trade—a contingency which we deal with below. For the theory that there is in any sense a fixed loan fund available to finance investment which is in all circumstances fully employed, or that the amount of the savings of the public always exactly correspond to the volume of new investment, is, we think, mistaken. At one time some such view as this appears to have influenced British policy. To a questionnaire from the International Labour Office in 1927 the British Government replied:—
 "The decision taken by the Government at the end of 1925 to restrict grants for relief schemes was based mainly on the view that, the supply of capital in this country being limited, it was undesirable to divert any appreciable proportion of this supply

from normal trade channels."* The Treasury White Paper, Cmd. 3331, p. 43, was also capable of interpretation in this sense. We gathered, however, from the evidence of Sir R. Hopkins that it would be a mistake to attribute this view to the Treasury at the present time.

(ii) It has been argued that, whilst investment spontaneously undertaken by private industry would help employment, there may, nevertheless, be some offsets to schemes deliberately engineered by the Government. For the effect of such schemes on the minds of business men might be such as to make them less inclined to launch out themselves. This might be true of "unfair" Government-aided schemes, by which some private firms received assistance from which other substantially similar firms were debarred. It might also be true that business confidence would be injured if the Government were to sponsor obviously wasteful, foolish or extravagant projects. But in general, provided the schemes are wisely selected, we see no presumption in favour of the view that "official" investment need seriously compete or interfere with "unofficial" investment. Indeed, on the contrary, if "official" investment is successful in restoring the volume of output and of profits, this may help to restore the business optimism which is a necessary condition of expansion. It may be that a dose of "official" investment will be helpful in breaking the vicious circle and restoring the conditions in which we can again increase our reliance on normal "unofficial" investment.

(iii) It has been objected that the tendency of such schemes will be in the direction of raising prices in this country and thereby hamper our export industries in their efforts to retain their hold on foreign markets. If our available plant were fully occupied, there might be much force in it. But in existing conditions, we do not doubt that output could be expanded in many directions in response to an increased demand with an insignificant increase in price. Indeed, some witnesses have gone so far as to maintain that, if output were to be increased, prices would be reduced, basing themselves upon the lower cost per unit of production when plant is fully employed.

In any case we should attach limited importance to this objection because, in so far as output cannot be increased except in response to a higher level of prices, this objection applies equally to all remedies for unemployment of whatever character, except those which involve a reduction of wages.

(iv) It is sometimes argued that home investment may not only embarrass our export industries for the reason just discussed, but

* "Unemployment and Public Works," International Labour Office, 1931 p. 30.

will also put a fresh burden on our balance of trade, because it will tend to increase our imports, both to furnish raw materials and to provide for increased consumption, particularly of food, by the newly employed. This is clearly, to some extent, the case. But here again it is an objection which applies to *all* remedies for unemployment. Any increase of employment is likely to bring with it increased imports of the raw materials of our industries and of the articles of working-class consumption. But this is scarcely a reason for not providing employment. The point is to be regarded, rather, as a reason for not embarking too rashly on large-scale schemes without arranging at the same time as to how the necessary increment of imports is to be paid for.

It is at this stage that considerations which are more of a monetary character come in. It is the business of the Bank of England so to regulate our net rate of foreign lending that it does not seriously exceed our available trade balance. A recovery of domestic output must, when it occurs, present the Bank with a problem of this kind. But schemes of capital development would have to be on a larger scale and mature with greater rapidity than is at all probable, before they would present the Bank with too heavy a task, unless they were to be undertaken simultaneously with a general breakdown of confidence due to other causes. We are still a creditor country on a large scale, and it would be an overwhelming condemnation of our present methods if proposals for increasing employment were to be rejected on the ground that we cannot pay for the raw materials which the men would handle and the additional food, etc., which they would consume, if they were to be brought back into employment.

(v) It is feared that State-aided schemes are likely to put some burden on the Budget and therefore to lead to the evils of increased taxation. If, however, we lump together—as we should for the purposes of this argument—the Budget and the Unemployment Fund, we feel quite confident that the relief to the Unemployment Fund and the additional yield of taxation, resulting from the increased employment provided by the schemes in question, would materially outweigh the direct cost of the schemes to the State.

(vi) A final objection—which may, we think, have weighed with the Treasury—is based on the possible effect of loans, made or sponsored or guaranteed by the Government, on the rate of interest on British Government securities, with the result of postponing the date at which large economies can be secured by a conversion of the War Debt to lower rates of interest.

This is a natural, but nevertheless dangerous, pre-occupation. Over any short period it is evident that the prices of Government securities may be affected by competing issues. But it is an exact inversion of the truth about the rate of interest to suppose that it can be reduced by *refraining* from new capital investment. Apart

from the short-period fluctuations around the equilibrium position, the rate of interest must tend to fall as the accumulated wealth and prosperity of the country in the shape of capital assets *increases*. The contrary view is based on some such fallacy as that "surplus" financial resources can be gradually built up, unembodied in any physical form. It is supposed that if we "save" a part of our current income and do not "use up" these savings in capital schemes, we can in some way hoard them up for use at a later date and that these "accumulated" savings will gradually strengthen our "financial" position. These ideas are probably derived from a false analogy between the position of a particular individual or firm and that of the community as a whole. For a particular firm can clearly accumulate "liquid" resources, unembodied in any physical form so far as the firm itself is concerned and constituting realisable claims on the rest of the community. But a little reflection will show that the community as a whole cannot increase its "liquid" resources by the various members of it building up claims against one another.

We have dwelt for a moment on this highly abstract point because mistaken ideas about it may be the explanation of much latent, unexpressed hostility or reluctance to the general idea of organised capital development. It is one of the cases where un-instructed commonsense tends to believe exactly the opposite of the truth.

48. The main obstacle in the way of remedying unemployment by means of organised schemes of investment is probably to be found, not so much in any of these arguments, as in the practical difficulties of initiative and organisation. It is not easy to devise well-conceived plans on a large scale. It is not easy to fit them into the existing scheme of things, even when they have been conceived, without all sorts of difficulties, frictions and delays. And, finally, the period of preliminary planning and designing, which must elapse before they will provide their full quota of employment, may be somewhat lengthy. It is difficult to *improvise* good schemes. If they are to be thoroughly wise and economical, they may often need as much as two years' preliminary gestation. Yet we have seldom been ready in recent years—though subsequent experience has taught us that we ought to have been—to sit down calmly to prepare plans for the remedying of unemployment two or three years hence. This difficulty has increased with time. For by now most of the good plans which can be quickly improvised have been used up, and the best plans still left in the cupboard are those which will yield their results most slowly.

49. If, therefore, the organised planning of capital investment is to be relied on as a remedy for our economic ills, it should, we think, be approached from now on in a somewhat different spirit from that which was natural three or four years ago. We must be

prepared, that is to say, to look some way ahead, and get to work on well-conceived projects without laying too much emphasis on the rapidity with which they can be executed.

50. There is the more reason for this, in that the problem of finding an outlet at home for a substantial proportion of our current savings is likely to be with us for some time to come. We recommend, therefore, that we should now attack the task of Capital Development in this country in a much more systematic and far-sighted manner than hitherto. It should not be an objection to a scheme that its execution will be spread over many years or that the period of preparation will be somewhat prolonged. After several years of living from hand to mouth, a point has come when it need not be considered an imprudence to look ahead.

51. It falls outside our scope to proceed to details in a matter of this kind. But we may illustrate our argument briefly :—

(i) A considerable part of the larger towns and industrial centres of the country need re-building and re-planning on a comprehensive scale. At present they offer neither beauty nor convenience nor health. Much of the industrial housing of the country is of an age when buildings of that character are, of necessity, only fit to be demolished. It seems an insanity to keep a large proportion of the building trade out of employment when this is the case.

(ii) Some of our staple industries need to be refitted and re-planned on modern lines, at the cost of a substantial capital expenditure. In several cases, there is much to be said for re-planning an industry as a whole. Apart from tariffs, and the like, we see no reason why our staple industries should wait before putting their house in order. In cases of proved necessity, we should not be opposed to measures of compulsion, in conjunction with the provision of adequate and cheap finance. It may be that we should develop an improved organisation for handling all matters of this kind. It would be outside our scope to pursue this subject in detail. But we think that efficiency and fore-thought might be much increased if a body were to be set up which might be designated the Board of National Investment, in the hands of which all matters relating to the deliberate guidance of schemes of long-term national investment would be concentrated. This Board might be entrusted with the duty of raising funds not only for the local authorities which now borrow through the Local Loans Fund but also for other local authorities including municipalities, for the telephones, for the roads and for such further schemes of national development as those which we have suggested above. But this is a big subject and it would lead us too far afield to develop it as it deserves.

(iii) The recommendations of the recent Committee on the Electrification of the Railway System obviously deserve the most careful consideration in this connection.

52. The fundamental objection to these expedients, in the minds of those who dissent from them, is, however, on a different plane of thought. They consider that all these devices are merely temporary shifts to enable us to postpone facing the problem, which sooner or later we shall be compelled to face, namely, that our money-costs of production are too high compared with those elsewhere; whilst at the same time they are of a character which, to judge from experience, are often used unwisely and may remain as an incubus on our economic system long after their special purpose has passed away.

53. The ultimate differences between those who feel this and those who think that it is worth while to gain a breathing space are not so much matters of theory as of the practical judgment of probabilities and of what is most prudent. But we suggest that a heavy burden of proof lies on those who cannot join with us in our plea for efforts to increase activity rather than to reduce standards. For if we can do what we are doing with nearly a quarter of our industrial resources idle, what might we not do if they were all employed? We are impressed for many reasons with what seems to us to be the greater wisdom and prudence of concentrating public attention on constructive schemes for encouraging national trade and national development rather than on efforts to drive down the general levels of salaries and wages. Let us, in conclusion, briefly recapitulate some of them:—

(i) If, at the present juncture, when we are near the bottom of a world slump of unparalleled violence, all countries alike were to seek equilibrium by competitive wage cuts, we should merely confirm the low level of prices and rivet on our shoulders an intolerable burden of debt fixed in terms of money.

(ii) We doubt whether it is wise to attempt fundamental adjustments, which may not be required, at a time so abnormal as the present, when similar difficulties are confronting all countries alike and when it is impossible to gauge with any accuracy the degree of adjustment which may be necessary in the long run.

(iii) We see no solution of the grave problem of social justice presented by any proposal to reduce salaries and wages whilst leaving untouched those money-incomes which are protected by contract.

(iv) Even if it were desirable to secure a large all-round reduction of salaries and wages, we foresee immense practical difficulties, perhaps insuperable difficulties, in the way; whilst the social costs of an attempt which failed would be incalculable.

(v) We prefer, therefore, to pin all our hopes on a recovery of world prices, and to strain all our efforts to secure it; whilst making, immediately, a great concerted attempt to avoid the immense waste of the national productive resources now going on. If these hopes are falsified by the event, much will by then have happened in the world, which we cannot now foresee. Public opinion, both here and abroad, will be ready for many things which it would be useless to consider now. And the whole matter will have to be reviewed again.

(vi) Meanwhile, we are not convinced that we cannot in the long run, when all our productive resources are at work, continue to support permanently, and even improve, our existing working-class standards. It may well happen, if we can gain a breathing space, that the recovery of world prices, the revival of business optimism, the reorganisation of the older British industries and the steady increase of technical efficiency may eventually render unnecessary a reduction in the prevailing level of salaries and wages.

THOS. ALLEN.*

ERNEST BEVIN.*

J. M. KEYNES.

R. McKENNA.

J. FRATER TAYLOR.

A. A. G. TULLOCH.

*SUBJECT TO THE FOLLOWING RESERVATION.

We have signed Addendum I in company with Mr. Keynes, Mr. McKenna, Mr. Frater Taylor and Mr. Tulloch, but, while approving the general approach to the subject, we do not necessarily agree with every statement therein. We think it vitally important to emphasise that to acquiesce in the present or a lower wholesale price level, with the idea of adjusting everything down to it, is fatal. We are in full agreement that the only possible policy is to try to raise the wholesale price level and to maintain or improve the standard of life.

If this cannot be achieved internationally within a reasonable time, we agree that national action of an emergency or short-time character should be tried.

We should have preferred the course of devaluation because of its effect upon the whole of the dead-weight debt and other fixed

charges, but we agree that great weight must be attached to the consideration that to endorse a de facto devaluation is easier than to devalue after a return to pre-war parity.

With regard to the tariff proposal in the Addendum we take the view that, precedent to any tariff, our other recommendation for a large measure of State planning and reorganisation, particularly in the basic industries, with the provision of Transport and Power as State services, should be put into effect. Then, if the alternative remained, tariffs would be preferable to all-round reductions in wages and salaries, provided that at the same time steps were taken to safeguard the export trade and to prevent the exploitation of the consumer.

In a general way we do not believe in tariffs, and we are rather more apprehensive as to their effects than the other signatories. Nevertheless, our view is, if we have to make a choice, it should be in the direction indicated.

The other points in the Addendum, such as schemes of Capital Development, Board of National Investment, etc., have our strong support.

THOS. ALLEN.

ERNEST BEVIN.

ADDENDUM II.

1. We recommend in Part II, Chapter III, of our Report that greater freedom should be given to the Bank of England in the employment of its reserves. But this greater freedom, which also involves greater responsibility, can hardly be used satisfactorily if our exchanges are to be subjected to a constant strain with the result that, while it might always be easy to lose gold, it might be hard to get it back except by means of a restriction of credit and relatively high interest rates which would be definitely harmful. For the greatest service which the monetary machine can render British industry and commerce at the present time is to maintain plentiful credit and cheap money rates, so that, as soon as some confidence returns, production and enterprise will be encouraged by means of an increase of purchasing power without any adverse effect on our exchanges. It seems to me, therefore, of the first importance that the surplus on our balance of trade should be increased. Notwithstanding that we own greater foreign assets than any other nation and receive annually from the rest of the world, as a result of the efforts and savings of past generations, a sum of some £300 millions in respect of interest, redemption and dividends and have the greatest "invisible exports", the surplus on our balance is now small, since the great bulk of these annual sums due to us is now required to pay for our imports. Our relatively high level

of internal costs and money incomes limits the power of those of our industries which compete with foreign industries either to export or to compete with foreign goods imported into this country, while it maintains internal consumption. Thus, as is shown in Part I, Chapter V, the volume of our exports has diminished and that of our imports has largely increased. It is this condition that renders a mere increase of purchasing power without a strengthening of our balance of trade impracticable.

2. In order that the surplus on our balance of trade should be larger, it is necessary to increase our exports or diminish our imports or do both. There appears no reason, however, to suppose that the normal course of events will by itself bring this result about. Rather the contrary. For, though many other adverse circumstances have since the end of the War pressed upon our export industries, our relatively high level of costs, tending to encourage imports and discourage exports, is of long standing and has undoubtedly contributed to their difficulties. It must be remembered that, before the world slump began, the great bulk of our unemployment, which for years has never fallen below about 1,000,000, came from those of our industries which were subject to foreign competition. Unless world prices rise again quickly and substantially, the disequilibrium from which they suffered is likely to be intensified if, as is happening now, other nations, whose economic conditions are more flexible, take earlier and more definite steps than we do towards some adjustment of costs to the lower level of prices. When a crisis like the present one overtakes all countries, in none of them does the business world sit with folded hands and wait for the monetary authorities to restore the conditions previously existing. Every industrial and commercial unit in each country is moved by the incentive of self-preservation to set to at once and try to adjust itself to the altered conditions. Its essential problem is to bring costs and prices again into such a relationship that the various factors of production, those which depend on profit as well as those receiving a fixed money-income, may obtain adequate remuneration, so that the operation of each unit will again become profitable, idle plant be restarted, output increased and, gradually, new development undertaken.

As a result of the great fall of prices without an equivalent reduction of costs, production all over the world is resulting in losses instead of profits. It is sometimes argued that a reduction of costs (in particular wage costs) will do nothing to alter this situation, because the reduction of costs is a reduction of incomes and involves therefore a destruction of purchasing power. But costs do not represent the whole of the incomes derived from production and still less do wage costs. These incomes include *profits*, and it is on profits being normal that the whole activity of private enterprise depends. The first impact of a reduction of costs is felt in an increase of profits or a substitution of profits for losses. A re-

distribution of the present proceeds of industry so that more of the proceeds would accrue to the shareholder and entrepreneur would not reduce the existing volume of purchasing power, but would induce entrepreneurs, by additional orders for raw material, plant and labour, to expand the volume of employment, and thus should lead rather to an increase than to a decrease of purchasing power. So long as enterprise promises a loss rather than a profit, no one will borrow and the normal process by which money is generated through the lending operations of the banks is interrupted. But a reduction of costs would alter the outlook, borrowers would come forward and money would become available to pay the additional incomes arising from the additional production. For this process to be continued, it is necessary that the banking system should be able freely to grant the necessary credit and for this to be possible without any weakening of our exchanges the strengthening of our balance of trade is again seen to be essential.

Moreover, in the present situation, where the products of the raw-material countries are so exceptionally low in price, the manufacturing countries will be forced to reduce their costs so far as possible in order to facilitate the exchange of industrial as against raw-material products. So long as, and to the extent that, world prices do not rise, there must, therefore, everywhere be a pressure to reduce costs, either by increasing efficiency or by a direct reduction of money-incomes.

3. If this diagnosis is correct, it is likely that, failing special action on our part, our costs will become higher rather than lower relatively to other countries' costs with the consequent tendency for profits to remain low, for capital to make efforts to leave the country and for exports still further to diminish and imports still further to increase. This tendency can only be reversed by (i) a diminution of costs by means of either (a) greater efficiency or (b) a direct reduction of salaries and wages, or (ii) special measures such as a tariff for the restriction of imports accompanied presumably by some direct assistance to our exports.

4. It would no doubt be agreed on all hands, even by those who support a tariff on other grounds, that by far the best method of diminishing imports and increasing exports would be by a greater increase in our efficiency relatively to the efficiency of our competitors. It is, indeed, only by constantly increasing our output for a given amount of labour that we can increase our standard of life. If wages are to be maintained, there is need of the most active co-operation towards the greatest efficiency and elasticity by industrial and financial leaders and by Trade Unions. I believe that there is a very great deal of leeway to be made up and that opposition to reform does not come from one side alone. If the object of the Trade Unions is to maintain *real* wages by a

higher output per man, they must recognise how vital it is to remove hampering restrictions, to facilitate the greatest possible mobility of labour and to prevent unemployment insurance from being itself the inevitable cause of permanent unemployment. But prejudiced resistance to changes obviously needed in the interests of the community is to be found also in those directing and managing industrial and public utility companies. If private enterprise is to hold its own, this resistance must be overcome. I believe, therefore, that there are still very big opportunities to reduce costs by greater efficiency in the widest sense of modernising both production and selling and limiting harmful competition. With the growing mechanisation of industry throughout the world, very cheap production of many kinds of goods is possible in more backward countries even with relatively unskilled labour. It is by constantly keeping in the van in the more skilled industries that we must maintain our position.

5. Secondly, we can reduce imports and increase exports by a direct reduction in money-incomes, i.e., salaries and wages. The cost of living has fallen in this country and real incomes have, therefore, risen by 18 per cent. since 1925 and by 12 per cent. since 1929. If there is a general rise in world prices, real incomes will again fall but, even if world prices were to rise, say, to the 1929 level, the disequilibrium which already existed in that year might continue to show itself as before in large and persistent unemployment. If prices remain at or near their present level and other nations adjust their costs to that level, while we do not, then our balance of trade will probably become constantly more unfavourable, and a situation might arise which might force an adjustment of *all* money incomes. If, on the other hand—and this is perhaps the most likely outcome—a new level is established by both prices rising and costs falling, then in so far as we have not relatively increased our efficiency, we must make at least equal adjustments in costs to those made by other nations to maintain even our 1929 position. It would appear, therefore, that, so long as prices remain at or near their present level, reductions of salaries and wages (particularly in the sheltered industries), and obviously in unemployment benefit too, are necessary if we are to maintain, and still more to strengthen, the surplus of our balance of trade and thus keep monetary conditions favourable to increasing enterprise and employment at home. Reductions in salaries and wages have taken place, and are taking place, in other countries, and particularly in Germany where Reparation payments cause a strong pressure in this direction. The developments in the rest of the world in the next six months or year in the direction either of rising prices or falling costs will show us more clearly the extent of our problem in this respect. What is certain is that no country can support permanently both a fixed exchange and a fixed level of money costs

in terms of gold which is out of equilibrium with costs elsewhere. Ultimately one or the other must give way.

6. If any practicable diminution of costs under the two headings of (a) greater efficiency and (b) direct reduction of money incomes is insufficient to bring us near to equilibrium, then I do not think that we can sit down and do nothing. In order to protect our exchanges and to enable the Bank of England to maintain credit conditions favourable to home industry, it might become necessary to take steps to restrict imports either by a general tariff on all imports or by a more specialised protective tariff, or by some restriction of unnecessary imports. I say nothing about the many other important aspects of a tariff, as I confine myself here to its relationship to the monetary problem. From that point of view it does not seem possible permanently to combine Free Trade with a rigid economic system under which money-costs in terms of gold remain out of line with those elsewhere and cannot be altered. But import duties, while diminishing imports, would tend also to diminish exports, unless accompanied by rebates, subsidies, or some other aids direct or indirect, which would cheapen the cost of our goods to the foreigner at the expense of the British taxpayer. It would, moreover, be unlikely that any new exporting industries, to which in these changing times we must look forward to help us, would get under weigh, unless they also received similar assistance. Furthermore, if any rise in prices internally, resulting from a tariff, merely leads to a proportionate increase in salaries and wages, and therefore in costs, then our disequilibrium will remain unaltered and a condition of affairs will be created in which another tariff "dose" will again be necessary to produce a temporary adjustment. It was, for instance, the experience in Australia that successive increases in the tariff followed upon, or were followed by, successive advances in the cost of labour, and involved that country in a vicious circle of ever-ascending costs and prices.

Thus the strengthening of our balance of trade by means of a tariff is not likely in my opinion to be as satisfactory for our export industries as a reduction of costs under the two other heads discussed above.

A protective tariff, as distinguished from a flat-rate revenue tariff, might increase certain exports as a result of giving the industries protected a sure foundation in the home market. But, having regard to our difficulties already existing in 1929, I am doubtful whether any assistance in the form of rebates, subsidies, etc., which it will be practicable to give under a tariff system will enable exports in general to flourish without a reduction in our costs relatively to foreign costs.

7. While an increase of home enterprise is of the greatest importance, flourishing export industries are in my opinion needed both to raise our standard of life and to employ fully our population.

as well as to strengthen the surplus on our balance of payments. One-third of all the workers engaged in manufacturing are dependent directly for their livelihood on the amount of export trade which we still retain. I disbelieve wholly in any plan of insulating ourselves from the rest of the world or that there is not future scope, as world prosperity grows, for our 40,000,000 people to trade on a much greater scale than at present with the remaining 2,000,000,000 people in the world. We may aim at using nearly all our savings at home so that the pressure of capital to find an outlet abroad is diminished, but it is hardly possible to suppose that if we live to "ourselves alone" the savings available for use can ultimately be as large, and therefore our standard of living as high, as they would be if we exchanged our products freely with all the world and maintained our commerce and our shipping. It is true that, until world conditions generally improve, we cannot expect any very great increase in exports. But to diminish exports and increase imports, as we are tending to do now, to the point at which we shall ultimately require the whole of the proceeds of the interest on and redemption of our foreign assets to balance the surplus of our imports, is not to lay our foundations very safely. In the first place we should cease to be a creditor nation and have no money to lend abroad. This would not only mean a great alteration in the position of London as a financial centre. It would also be very unfortunate from the point of view of the development of the British Empire. We should be surpassed in wealth and influence by those who took our place as creditor nations. Moreover, our foreign assets constantly require replenishment, for they are always being diminished by repayment, by losses, or by the failure of our debtors and for this reason alone some surplus on our balance of payments is required.

8. I do not consider that greatly increased capital expenditure by the Government or other public authorities is a solution of our difficulties. There is everything to be said for schemes, however large, which are in themselves desirable and remunerative (such as railway electrification may prove to be) and which improve our national plant and lead directly or indirectly to large economies in costs. The fact that we are spending over £120,000,000 per annum on unemployment without anything to show for it is a strong additional reason for not rejecting off-hand projects of real promise. But the efficacy of public expenditure is severely limited by practical difficulties. Any large scheme requires many months of examination and preparation and, if commenced now, could not be actually taken in hand for at least one or two years. If a number of very large schemes were projected now, the Government might come with great demands upon the capital market at the time when conditions were improving and private enterprise itself might need large capital funds. Outside such an exceptional case as the electrification of the railways, large and remunerative schemes are probably quite

limited. If they are not remunerative, but involve annually a burden for interest and sinking fund on the Budget, they would have the great demerit of adding permanently to our expenditure at a time when direct taxation is already too high. Anything, indeed, which increases the present or prospective burdens on the Budget obviously requires the narrowest scrutiny. Whatever may be the merits of capital expenditure by the Government, they do not compare in their effect on unemployment and industry with the placing of private enterprise on a more profitable basis.

9. If prices rise not at all or only slightly and meanwhile other countries adjust themselves either by a reduction in costs or by going through a process of inflation, no lowering in costs, either by greater efficiency or by a reduction in non-contractual money incomes, can be expected to solve our problems. The burden of our high costs and our huge debt might then prove intolerable, unless mitigated by sacrifices on the part of *all* sections of the population. The problem of contractual money-incomes is, however, extremely complex, and differs fundamentally from that of salaries and wages in that the recipient of a contractual income must accept the risk of loss from movements in the value of the currency equally with the prospect of gain. The "rentier" has gained by the fall in prices; he will lose, if they rise again. An extreme illustration of his risks may be seen in the cases of Germany, France and Belgium, where a permanent depreciation of the currency has involved him in final and irrecoverable loss. Moreover, the "rentier"—and that term covers both individuals and institutions—is in fact inextricably mixed with the investing part of the community, which as a whole, has made some gain from the fall in prices through holding fixed-interest securities, but has at the same time suffered through the writing down or complete loss of part of those holdings and through the very heavy losses on their investments in shares. It is this complexity which makes the application of any general scheme to all money-incomes so difficult, and which therefore makes a rise in world prices so essential to any normal solution of our difficulties.

10. Finally, the difficulty of securing a world rise of prices and the dangers of the present world economic situation are greatly aggravated by the Reparations and Inter-Allied debt problem. In the first place, the pressure on Germany to increase her exports necessitates the utmost possible reduction in all her costs, including all salaries and wages, which have in fact already been very considerably lowered. This, in turn, increases the pressure on all her competitors and particularly on us to follow suit. Germany is so important a factor in overseas trade that this influence in the direction of holding prices down must be considerable. Moreover, the payment of these great sums, mainly to the United States and France, very considerably aggravates the

problem of the debtor countries referred to in Chapter II of Part II of the Committee's Report, renders the German situation dangerous to the whole international credit structure, and accentuates the tendency of gold to flow to the United States and France which is particularly undesirable at a time when neither of them are lending their surplus back to the world. If it were possible to wipe out the Reparations and Inter-Allied debt payments, by far the greatest single step would, in my opinion, have been taken towards the recovery of world prosperity. Indeed until some fresh settlement of this problem, rendered necessary by the great fall in prices, is made, I do not believe that we can expect any recovery.

R. H. BRAND.

ADDENDUM III.

Introduction.

1. I desire in this note to express my views upon the present situation and upon the various proposals which have been put forward as cures, or at least as palliatives, for the evils complained of; further, to present some observations upon certain of the problems which fall directly within the Terms of Reference and have already been touched upon in the Report of the Majority of the Committee.

2. It is common ground that the difficulties with which we are contending result from the accentuation of the pre-existent local depression of trade and employment through the world depression, which, beginning in the second half of 1929, has now lasted for nearly two years without showing any marked tendency to come to an end. The disequilibrium between prices and costs, which was a special characteristic of this country before the world depression, has now become a world phenomenon. But the fact that disequilibrium has become general means also that the degree of disequilibrium in this country has now grown cumulatively greater than it was before.

The Local Situation.

3. It is obviously impossible for this country, by any special action it can take by itself, to cure the world situation; although as a country which is one of the two largest creditor nations, with a capital market upon which a large part of the world habitually relies, with a Central Bank enjoying great international authority and prestige, and with a population with a high per capita volume of exports and a high per capita consumption of internationally traded goods, we are in a position powerfully to influence the course

of world events, even if the allowance is made for the special disabilities under which we are labouring. Our duty in this connection would seem to be a twofold one: to abstain from action which, if generalised, would result in making the world situation as a whole worse than it was before, and to follow policies which, whilst benefiting ourselves, will also help to alleviate the world situation. Apart from all other considerations, therefore, and considering solely the world situation, to embark upon a régime of tariffs and to refuse obstinately to face the question of costs are both undesirable. For to adopt the first will undoubtedly encourage a general tendency to further economic isolation on the part of other countries, thus impeding the recovery of world trade; whilst to refuse to face the second issue will lay us open to the charge that we are seeking the co-operation of other countries in obtaining a rise in the world-level of prices because we have neither the will nor the ability to take the steps necessary to bring us into line with what is taking place elsewhere. We must be in a position to convince other countries that we are not dependent on their goodwill to save us from difficulties which, however mistakenly, they believe to be largely of our own making, before we shall be in a position to represent to them successfully that co-operation in the field of credit is a necessary part of the process of recovery. The mischief will not stop at this point, however. By one means or another, the world, as a whole, will climb out of the present depression, as it has recovered from previous ones. If recovery takes place in the outside world without any definite steps towards international co-operation having been achieved, it is certain that they will then become impossible for a long time to come; for it is not in periods of prosperity that efforts of this kind are likely to be inaugurated. And our moral and economic position alike may be permanently injured; our moral position by our failure to convert the rest of the world to our way of thinking; our economic position by our failure to make the adjustments necessary to accommodate ourselves to changes in the world as a whole.

The World Situation.

4. As far as the world situation at the moment is concerned, two solutions are presented for consideration. It is urged on the one hand that a concerted effort should be made to raise the level of prices; it is urged on the other that the way out of the present impasse is to reduce costs.

It is argued by some of those who support the first solution that it is impossible to solve the problem of a depression in any other way: for a reduction of costs cannot result in anything else except an endless sequence of changes, in the course of which prices first fall, to be followed by falling costs, which in their turn result in prices falling again, requiring a further fall in the level of costs and

so on. Thus the only result of the process is a cumulative fall of prices, which has merely the effect of increasing the burden of indebtedness and all other fixed charges, and does nothing to revive industry and employment.

It is argued by some of those who support the second solution that concerted efforts to raise the level of prices by means of additional credit-creation are not in any case likely to be made. Secondly, that a period of falling prices and depressed trade brings with it a necessary process of elimination of unsound borrowers and undertakings whose disappearance is necessary for a revival of sound business and of confidence in borrowers—a process of weeding out which would be delayed if plentiful credit were immediately available. But the longer the process is delayed, the greater will be the liquidation necessary when, at long last, further credit creation proves unavailing to prevent the collapse of unsound institutions. Thirdly, it is argued that the process of credit-creation, if successful, involves the danger that revival may take place upon a scale and with a rapidity that may make it imperative quickly to withdraw this additional quantity of credit. But in the face of violent opposition by the business classes this necessary policy of subsequent contraction may prove impossible, and the overstimulation thus given to the upward phase of the cycle may be followed by an even worse collapse than the one to overcome which the policy was first attempted.

5. Neither set of contentions appears to dispose conclusively of the policy against which it is directed, and there seems to me to be no necessary inconsistency in the simultaneous application of both policies. To demonstrate that if costs are cut there will be a revival of trade is not tantamount to a demonstration that, therefore, the process of revival should be accomplished *solely* by this means. To demonstrate that a process of credit expansion would in the end revive business is not the same thing as proving that exclusive reliance should be placed on this method of attacking the problem. For it may well be that difficulties which would manifest themselves if only one method were employed may be absent if both are utilised.

(a) The reluctance to admit that a reduction of costs will alleviate the situation resulting from the present universal maladjustment between prices and costs, springs from a confusion between a reduction of costs and an effective destruction of purchasing power. The argument upon which this reluctance is ultimately based can be stated as follows. Money costs represent income accruing either to wage earners or others taking part in the processes of production, and in the form of income, therefore, constitute the purchasing power from which flow the receipts accruing to producers. If costs are reduced, therefore, it follows that purchasing power is diminished, and the relationship between receipts and costs remains

unaffected. At the lower level of costs, receipts will still be insufficient to cover costs, just as they were at the higher level of both costs and receipts.

(b) But the fact is that a reduction of costs is not necessarily tantamount to a proportionate reduction in aggregate receipts, because, so long as the costs remain above prices, unemployment ensues. It follows, then, in spite of the fact that what is paid out in costs reappears later in the form of receipts, that the aggregate volume of receipts is less than it would have been if costs had been lower and unemployment had been less.

Again, given the present level of prices and costs, production, it is freely admitted on all hands, results in losses to the entrepreneur. A redistribution of the present proceeds of industry, such that more of the proceeds would accrue to him, and less to the other factors of production, would not reduce the *existing* volume of purchasing power, but would induce him, by additional orders for raw material, plant and labour to expand the volume of output and of employment, though it might admittedly, so long as the aggregate volume of employment had not been appreciably affected, change the nature of demand somewhat through changes in the distribution of the proceeds of industry. But the mere fact that unemployment was falling would restore to the industries producing consumption goods part of the demand which they might have temporarily lost. It would not be true to argue that such an impulse to the expansion of production would be held up by the impossibility, at the new level of costs, of finding the volume of purchasing power, in terms of money, necessary to sustain it. For if prices and costs are in adjustment, the *de facto* volume of purchasing power available must always be sufficient. But it is not difficult to see further that once given the emergence of profits to the average entrepreneur, a series of repercussions in the field of credit-creation are likely to take place which will remove the danger (if any) that the expansion of production and employment will be checked by insufficiency of purchasing power. For entrepreneurs are more willing to borrow, and bankers more willing to lend, in a period when profits are emerging than in a period when industry as a whole is sustaining losses. It may be argued, therefore, that the adjustment of costs to prices is the necessary preliminary to the inception of monetary processes which will initiate an upward movement of prices, and thus assist such adjustment in those portions of the field of production where it has not already taken place.

(c) The view that an adjustment by means of a fall of costs, rather than by means of a rise of prices, is objectionable, not because it fails to achieve its object but because it would increase the burden of debt charges, requires separate consideration. If prices remain permanently at a lower level, the purchasing power of

debts will increase considerably; as they will equally increase if the reduction of costs takes the form of increasing efficiency. But if the adjustment of prices and costs results in increasing employment and output, the real burden represented by debt charges upon output as a whole may still be a smaller one than it would have been if the adjustment had not been made. For, if the adjustment had not been made, the debt charges would have had to be met out of a smaller dividend. Moreover, as has just been argued, it by no means follows, once prices and costs have been brought more closely into line than is now the case, that a low level of prices will be permanently imposed upon producers. Purchasing power has not been destroyed but only redistributed; and a revival of activity will, partly in virtue of the banking repercussions associated with it, partly in virtue of the direct effects produced by increased trade, help to raise the price level. There is, therefore, no reason to suppose that an adjustment of costs to prices must involve a level of prices permanently as low as that now existing: nor that, even if it did, considerations relating to the burden of indebtedness would be a final reason for refusing to make the adjustment, *if no other solution were possible*.

(d) On the other hand, it is impossible to deny that the process of adjusting costs to prices is one which necessarily involves much hardship, and individual inequality and difficulty, and raises such far-reaching issues of social stability, that, if it could be avoided, even if only in part, by cheap money and credit expansion, very weighty arguments would have to be advanced to justify inaction on the part of the banking authorities. The argument that it may later be necessary to retrace the steps taken and to deflate credit in order to avoid over-expansion at that stage, cannot be considered a sufficient reason against present action. For, in all probability, the process of recovery from a depression so severe as the present one will be slow, and ample statistical and other material is available for the guidance of the monetary authorities, nor will the technical forms, which any repressive measures (which may indeed subsequently prove necessary) would have to take, present any unusual features. In these circumstances the case against present action, *on these grounds alone*, cannot be considered conclusive, though I would agree that the dangers apprehended are by no means entirely imaginary. Nor, in my opinion, can the argument that some liquidation of weak positions is a necessary part of the process of recovery be pressed too far. For, as the depression continues, the circle of weak borrowers becomes wider and wider; for the losses sustained as a consequence of the depression gradually undermine the position even of those who were originally entirely creditworthy. To assert so much is by no means to deny the truth that in the upward phases of every cyclical movement of trade some branches of production and some sources

of supply become over-developed, and that additional credit creation cannot overcome the difficulties associated with the position of such industries and areas. All that is contended for here is that efforts to prevent the general situation from deteriorating too markedly should not be withheld because such efforts will be unable to solve the special difficulties associated with particular cases. To attempt to prevent prices from falling further is not "inflation" but an effort at stabilisation.

6. Thus the short-run problem must be attacked, in my judgment, both from the side of cost-reduction and of credit policy. The important issue from the standpoint of this country is the price level which will ultimately emerge as the result of the policies actually pursued. It would be unwise to calculate upon a price level being reached, even if recovery takes place now, which would restore the precise relationship which existed, before the events of 1929, between the level of British money incomes and prices and those of the outside world. Even this relationship was an unsatisfactory one. From the standpoint of this country, then, a still lower level of outside costs and prices would mean an intensification of our problems, and this makes the task of suggesting remedies still more difficult than it would in any case be.

The Economic Position of Great Britain.

7. It is impossible to judge between the merits of the various alternatives which lie before this country without some previous consideration of its economic position. If all the available evidence pointed unambiguously in a single direction, choice between alternatives might be easier. But, unfortunately the position is not so simple; the evidence available allows no such unmistakeable inferences to be drawn.

(i) It would be an error to assume that there has not been a substantial increase in productivity during the last decade and unjustifiable to argue that the general economic position is one of unrelieved gloom. On the contrary, unnecessary apprehensions on these grounds are entertained both at home and abroad, and the widespread impression to the contrary which has been allowed to prevail has itself been a factor of some importance in aggravating the undoubted difficulties of recent years. It appears from the evidence submitted to us that the index of output per head rose between 1924 and the first quarter of 1930 by as much as 13 per cent. (manufacture and mining combined) whilst aggregate output rose during the same period by nearly 10 per cent., and in manufacturing industry alone by 13 per cent. General considerations, moreover, warrant the assumption that considerable improvements in productivity must have taken place. For, though a large part of the explanation lies in the change in our favour of the terms of trade, owing to the extraordinary fall in the prices of food and

raw materials and the reduction in the net volume of our foreign investment, the paradox of a rising standard of life coinciding with unemployment both for capital and labour upon a considerable scale throughout the last decade would otherwise be inexplicable.

(ii) In spite of the known difficulties in transferring labour from one occupation to another, it is well-known that transfer on a considerable scale has in fact taken place, with the result that the proportion in different industries has shifted markedly. Moreover, whilst between June, 1924, and August, 1930, the numbers of unemployed in all insured industries rose from 1,085,000 to 2,119,000, the numbers seeking employment rose from 10,430,000 to 12,094,000. The numbers actually in employment at the later date were thus 600,000 in excess of those employed at the earlier date, in spite of a doubling of the volume of unemployment.

(iii) Though the volume of our export trade in 1929 was still below what it had been in 1913, nevertheless it is not the case that particular branches of British export industry have shown no elasticity. The contrary impression which has grown up is due to the fact that in 1913 so large a proportion of our total exports of manufactured articles were concentrated in just those groups of commodities which have suffered severely since, so that, if a weighted average of all exports is taken, the total still falls considerably below that of 1913. But this conceals the important fact that, in other directions, the volume of British exports in 1929 was above that of the last pre-war year. Thus it appears from the calculations of Professor G. W. Daniels* that, taking the volume of trade in British exports (articles wholly or mainly manufactured) as 100 in 1913, the volume in 1929 was only 86.1. But out of the twenty groups comprised within this rubric, twelve showed an increase over 1913, eight showing a decline: the latter apart from the Miscellaneous Class including Cutlery, Machinery, Manufactures of Wood and Timber, Cotton and Woollen and Silk Yarns and Manufactures and Apparel: whilst other groups (including even Iron and Steel and Manufactures thereof) had either maintained their position or in some cases had substantially improved it.

(iv) Nevertheless, there are other aspects of the situation which are not so encouraging, and which require to be taken into consideration before final judgment can be passed.

(a) The fact that the terms of trade have shifted in favour of this country has meant that we have been able to buy our imports of food and raw materials on cheaper terms, i.e., to obtain the same or a larger volume of such goods at less expense to ourselves in terms of the volume of exports. This necessarily reacts on the volume of employment in the exporting industries, other things being equal. But what is true of this country vis-à-vis of countries

* Recent Changes in the Overseas Trade of the United Kingdom. Manchester Statistical Society. November 1930, Table VII, p. 17.

producing foodstuffs and raw materials, is equally true of all other industrial nations and does not therefore serve fully to explain why the rate of growth in our exports should have fallen behind those of our leading competitors. The recent investigations of Mr. Loveday have shown that some of the conventional explanations, particularly the handicap imposed by an appreciating currency, fail to account for this phenomenon, since other countries which have undergone the same monetary experiences have expanded their trade more rapidly than we have.*

Moreover, if it is argued that our older, staple export industries have suffered from the effects of changes in demand which lower prices for our exports could not have prevented, it must be borne in mind that this is only part of the truth. For competition between articles is, partly at any rate, a matter of price, and lower prices might have prevented, e.g., part of the substitution which has been going on between different fuels. Moreover, part of our export markets have been lost to new competitors producing the same article, e.g., cotton goods, and in this case, at least, it is clear that comparative prices must have played a considerable rôle.

(b) Again, even before the world-depression began, the volume of unemployment was in the neighbourhood of one million. It is known that this figure does not represent an unchanging army of individuals crystallized out of the main body of wage-earners and unable to find work, but largely represents a body of persons sometimes in employment and sometimes out of employment. Moreover, absence of adequate training or of natural aptitude, housing difficulties and the like causes of immobility between employments (including the psychological and other effects of unemployment insurance) make it impossible to argue simply from the fact of unemployment to the fact that existing levels of wage-costs are necessarily too high to enable the expanding trades to absorb the whole of the labour available at the existing level of selling prices. But, since it is probable that with lower wage-costs a lower level of prices could have been established, and therefore a lower level of demand could have been tapped, there is reason to suppose that *part* of the failure to absorb unemployed labour must be connected with the level of British costs. How much of the continuing volume of unemployment can be explained on this ground alone it would be difficult to say, but in my opinion it is a considerable part of the whole. For a rigid level of costs not only fixes the margin of profitable exploitation of *existing* industries at a point different (and higher) than it would have been if costs had been lower, but also inhibits *new* industries from establishing themselves at all.

(c) Lastly, there is the undoubted fact that throughout the greater part of the period which has elapsed since the return to the gold standard the Central Bank has found the task of main-

* A. Loveday. *Britain and World Trade* : especially pp. 152-171.

taining the international parity of the pound sterling a difficult one. The difficulties with which the Bank of England has been contending can be easily enough explained, if the fact is accepted that, at the time when the gold standard was restored, the then level of sterling prices, costs and money-incomes was inappropriate to the parity chosen, and that, in the absence of a rise in world prices sufficient to diminish the disparity between world costs and British costs, the only alternatives open were to reduce British costs sufficiently, or to pursue a monetary policy which would offset the tendency to increasing imports and diminishing exports resulting from an unadjusted cost position. There is thus no difficulty in understanding the course of monetary policy in recent years. The easiest method of adjusting the money market position which arose from inelastic exports and rising imports, combined with the desire to invest abroad, was to maintain a level of money rates which would allow of the use of foreign balances as an equilibrating item.

It is true that the problem thus presented to the Bank of England was eased by the gradual improvement in the volume of British exports before the world depression began, and has been eased since by the fall in the world prices of food and raw material imports. Moreover the figures cited in paragraph 260 of the Report warrant the assumption that there has not been, in recent years, a *progressive* increase in our reliance on the method of equilibrating the Balance of Payments by taking up foreign balances, but rather the contrary. Nevertheless, the Bank is still faced with the task of preventing too rapid an outflow of the volume of foreign balances now held here: the level of money rates is still managed with this end in view, and the assumption that our monetary position would be more comfortable if the level of our costs permitted a greater elasticity in our export trade is not invalidated by showing that, so far as our short debt position is concerned, the dangers and difficulties of the position have been somewhat exaggerated in the past, and that, over a course of years, improvement had been taking place. But in so far as optimism is warranted on this ground, and if the fuller information now available suggests that the precariousness of the position of the Balance of Payments has been exaggerated, one is entitled also to draw the inference that some of the emergency measures which have been put forward as means towards *improving* the Balance of Payments are perhaps not as urgent as they appear to some of my colleagues.

8. The attitude to be adopted towards measures for overcoming the present difficulties must to a large extent turn on the assumptions to be made regarding the future developments of the economic position of this country. If the view is taken that factors intrinsic to this country make continued participation in world developments on the old scale impossible to us, or if, alternately,

the opinion is entertained that the trend of world events is in any case such as to require a fundamental change in the direction of our productive efforts, more drastic modification of our economic institutions may be required than would otherwise be the case.

It is certainly one of the consequences of the increasing command over resources that all over the world the demand for direct services and for luxury goods is expanding more rapidly than the demand for the older staple products: a change which is indicated by the growth in all countries of the distributive trades, the amusement-industries, and so on. From the standpoint of the older exporting nations, such developments of demand involve both losses and gains. In so far as they can no longer rely upon the same proportion of the population finding employment in the traditional manner it implies immediate loss: in so far as these changes in demand imply alternative methods of employing population within their own frontiers the loss is balanced by gain: for the growth of these industries everywhere implies that, provided the transfer problem can be solved, there is no reason to suppose that a failure of foreign trade to expand in the old directions means a permanent loss of well-being. Moreover, a failure of demand to expand does not necessarily, in the case of the older industries, mean that the *absolute* scale of the industries concerned must *contract*. All that it means is that they will no longer expand at the old rate. Provided that there are not at work specially deterrent *local* influences, the shift in demand does not mean a present loss of employment, but only that, in the normal course of development, other industries and employments will gradually assume greater importance. And, as regards the newer industries producing luxury goods, the development of an export trade in these is stimulated by the very causes which explain the relative stagnation of the older staple trades, i.e., the emergence of new kinds of demands.

9. Turning now to the case of Great Britain, the following conclusions appear to be warranted:—

(a) The material prosperity of a country does not depend directly upon whether it is engaged upon manufacturing for export (thus obtaining indirectly the goods it requires for its own consumption) or whether it meets its own needs for goods by direct local production, but upon the productivity of its capital and labour. Thus a decline in foreign trade is consistent with increased prosperity, provided that increased efficiency means the replacement of foreign by home-produced goods at falling costs, and provided that demand shifts towards sources of satisfying wants which cannot be supplied from abroad (e.g. services).

(b) On the other hand, so long as world population and trade continue to expand, there is no reason to suppose that

this country cannot continue as a great exporting nation, furnishing either staple products or new products, so long as our costs are upon a competitive level.

(c) Even if there are changes in the world situation disadvantageous on balance to us (and some unfavourable phenomena are certainly present) one-third of our workers in manufacturing industry are still engaged in working for export. Any emergency measures which may be adopted for the purpose of reducing this proportion cannot possibly appreciably diminish the magnitude of the population so engaged in the *short-run*, whilst they might have serious repercussions upon that part of our foreign trade which under any circumstances we would require to maintain. And the *indirect* benefits which might be expected to follow from such measures, i.e., the stimulation of demand for products of many different kinds due to increased employment and production, would equally follow if the mass of unemployment in the export trades were reduced, e.g., by a reduction of costs.

10. The nature of the problem which we have to solve is often misunderstood. It is not merely a question of providing alternative sources of employment at *any* standard of life: any amount of employment of a sort could be found by the simple expedient of cutting off all foreign trade. The problem is to find alternative sources of employment yielding (without adventitious assistance through subsidies or other transfer-expenditure) at least as high a standard of life to the mass of the population as was yielded by the old sources of employment. Whatever may be the case in the long run, I do not myself believe that this problem can be solved without the assistance of vigorous and flourishing export industries: or of industries capable, by their efficiency, of replacing goods at present imported by new domestic production.

Suggested Remedies.

11. It is, I think, common ground that a failure of world prices to rise above the very low level which they have now attained—still more, a further fall—would, in any event, create a situation of great gravity for this country, both as regards the question of adaptation to the new level of costs elsewhere, and also as regards the continuance of the stream of income from abroad, representing interest and sinking fund payments on its past investments. Something in the nature of the National Treaty advocated by Mr. Keynes and those of my colleagues who have signed Addendum I might then become almost inevitable, and the sacrifices of money-income called for from producers of all classes might have to be compensated by additional taxation on rentier and contractual incomes (or alternatively by revalorisation agreements on the lines of those

which have sometimes been adopted after a period of currency instability, so as to bring debts more into consonance with the altered value of money). There is no need to emphasise the great difficulties which would attend measures of this kind, but their immediate adoption is not in question. Some recovery of world prices is to be expected, and in so far as prices do recover, the margin of cost disadvantage to be overcome will correspondingly diminish. If it is admitted, on the one hand, that there might have to be an adjustment of the scale of money-incomes of so abnormal a kind as to require a special procedure, and if it is admitted, on the other hand, that some adjustments of incomes are "normal" in the sense of arising inevitably out of the changing conditions and circumstances of economic life, and therefore require no special justification, one is left with an intermediate region of adjustment, greater than the normal, less than the absolutely abnormal, which does require separate discussion. But until we have seen at what level of prices world recovery will take place, this intermediate region is necessarily indeterminate in magnitude. The alternatives before us are simple. We may attempt to adjust costs: or we may attempt by special devices to interpose a cushion between ourselves and the outside world, in the hope that thereby we may avoid, in part or in whole, the adjustments which might otherwise seem inevitable. Three other alternatives are also open to us: to do nothing at all, but deliberately await events, hoping that a favourable further turn of the tide may float us away from the dangerous rocks towards which we are drifting: alternatively by some national action (if that be possible) to change the whole direction of our productive effort. Lastly, we may devalue or abandon the gold standard.

12. If we do nothing at all but wait upon events we must face the danger, though not the certainty, of a cumulative loss of export markets, of growing lack of confidence in the economic strength of Great Britain as a consequence of continued large-scale unemployment, heavy fiscal burdens, and of what would be read by the world as our evident and acknowledged inability to overcome the rigidities and inelasticities of our economic and social system. We would not, in any case, have to face any sudden catastrophe, for so long as our foreign balances are not swept away by a sudden panic, the excess of our visible imports over our visible exports can be compensated by a gradual decline in the volume of our *new* foreign investments: a decline which would become inevitable if increased taxation reduced the margin of new saving through inability on our part to expand the national income. All that would happen would be that our economic strength would gradually diminish, and with the diminishing of that strength would go the hope of a progressive improvement of the standard of life of the population as a whole. What has just been said assumes no

improvement in the world price-level, and adjustment to that price-level by all countries other than ourselves : a process which in any event involves the danger that our sterling assets in the shape of foreign loans will have suffered a substantial diminution in consequence of voluntary or involuntary default. For my own part, I do not believe it possible to sit still with folded arms waiting for something favourable to turn up.

13. There is no reason to reargue here the case against a tampering with the standard of value. Independent and premeditated action on these lines would represent such a violent breach of national faith, and give such a blow to confidence that its ultimate consequences can hardly be foreseen. That they would be of the gravest and most unfavourable kind, at any rate to a nation situated as we are, can hardly admit of doubt.

14. National action to change the direction of our productive effort would have to take the form of a large scale development of Public Works, planned in advance to absorb a large proportion of the national labour-force for perhaps a whole generation. As a contribution to our immediate difficulties such a plan suffers from the most obvious defects. So long as capital equipment and labour-power are out of employment, and current savings are hoarded because of lack of confidence, it is, of course, true that national works are not impossible because they cannot be financed except at the expense of withdrawing resources from other possible avenues of employment. But the most urgent problem which we have to face concerns the export industries, and it is not easy to see how plans of national development would much assist these industries in the short run. Development works of any kind will (i) absorb unemployed labour of *some* kind, (ii) give assistance to the constructional trades supplying material and equipment, (iii) indirectly stimulate demand for other labour through increasing the purchasing power of workers and employers engaged in the constructional trades and of the workers directly employed in the development work itself. But the indirect demand under heading (iii) will not necessarily be confined to home products, so that, to the extent that imports of foodstuffs and raw materials increase, no direct stimulus to home demand will result under this head. How much assistance will then be afforded to the capital and labour in the export industries must thus be very conjectural, depending upon (a) the rapidity with which plans can be developed, (b) the amount of work which can be set in hand within a given period of time, (c) the nature of the work undertaken, (d) the demand generated directly, and the proportionate distribution of this demand between home and foreign products, (e) the direct proportion of the demand accruing to industries formerly engaged in making for export, (f) the transferability of labour and capital to take advantage of improvements in demand for goods other than those which they formerly helped to make. As a short-run contribution to the

problem, I cannot believe that the policy of Public Works has much to offer to the *export industries*, in which, after all, the bulk of our unemployment is concentrated. As a long-run contribution to our economic problems, it raises other issues, both fiscal and economic, which fall outside the scope, however interpreted, of the present inquiry.

The Problem of the Tariff.

15. It has, however, been suggested that a remedy lies within our grasp, which *can* be applied in the short-run, and from which, at any rate in one of its forms, much can be expected. It has been suggested that the imposition of a Customs duty (of say 10 per cent.) upon all imports, accompanied by a subsidy upon all exports (also of 10 per cent.) would (a) improve our balance of trade, (b) reduce the real burden of *all* the sterling costs of British industry, including fixed charges, (c) increase revenue, less, of course, the cost of subsidies. It would be equivalent in its effects upon *home-income* to a devaluation of 10 per cent. in the standard of value, without raising any of the difficulties attendant upon a direct attempt at devaluation. Even if such a tariff policy proved impracticable, import duties could still be imposed, accompanied by aids to the export industries, similar in effect to, though not identical with, a direct subsidy. It has even been suggested that such a tariff, in the light of our present situation, is the ideal method of securing the optimum distribution of our national resources.

This last point, though of no great practical importance, would, if it were true, be of great scientific interest. I believe it to be invalid. A flat rate of import duty accompanied by a flat rate of subsidy on the f.o.b. value of exports would indeed make conditions even as between the export industries and industries using home-produced materials and domestic labour, and selling in the home-market. But it would *not* make conditions even as between the production of either of these classes of goods and the production of goods intended for home consumption out of imported raw materials: nor would it make conditions even between the first two classes of goods and the rendering of services, in so far as those who render services would have to pay more than before for raw materials and equipment without receiving a subsidy. (Are, e.g., ships built of foreign steel but owned by English firms on the British register to receive a subsidy or not?) But this point is of quite subsidiary importance as compared to the other issues raised.

16. It is only as a possible solution of the monetary difficulties associated with the present emergency that I am concerned with this, or indeed any alternative, proposal involving the imposition of duties upon imports. As a suggested method of overcoming disequilibria associated with monetary difficulties the tariff suffers,

indeed, from the fact that it is unable to remove the fundamental defect which is complained of, so that, unless it is constantly being adjusted to meet changes in the situation, its use as a monetary instrument is liable to create new difficulties of its own. Moreover, a review of history does not warrant giving the tariff a very high place as a method of relief from monetary distress. But neither a *priori* considerations nor historical example constitute, in our present circumstances, a sufficient answer to the case put forward by some of my colleagues.

I demur, in the first place, to the definition of this expedient as an emergency measure; one which can be dropped without difficulty when the circumstances which called it into existence have passed away. For such a tariff would tend to perpetuate those disparities between British and foreign costs to the existence of which it would, *ex hypothesi*, owe its existence. So long as these disparities lasted, retention of the tariff could and would be urged as a method of defence, but so long as it was hoped that the tariff would remain, there would be no need to make the efforts necessary to overcome the disparities involved. It might, perhaps, be said that some recovery of world prices is to be expected and that, in so far as foreign money-costs rose, the fact would become so patent that a widespread agitation directed to the removal of the duties would follow. But if a rise in world prices is to be seriously hoped for, within a measurable period of time, this very fact would be a decisive reason for avoiding (unless other grounds than the nature of the present emergency can be invoked) any measures which, once imposed, would involve, in the virtue of their very nature, their permanent retention. If a revival of world prices is not to be hoped for, the tariff ceases to be an emergency measure and would become an integral part of the fiscal and economic system of the country: the more certainly, the longer the period of time involved. Moreover, the tariff history of other countries shows with what tenacity a tariff is clung to, even when, to the eyes of impartial spectators, the industries calling it in aid are clearly able to do without its assistance. If the tariff does what it is asked to do during the emergency period, there will be a natural reluctance to part with so valuable an instrument: if it does not, it can be pleaded that failure to achieve success was due to the inadequacy of the tariff protection actually afforded. If the tariff is to be adopted at all, it is likely to be permanent.

But if anticipations in this respect are well-founded it appears impossible to suppose that Parliament and public opinion will be concerned mainly with the monetary (and supposedly temporary) aspect of the proposal. Discussion would turn, and turn rightly, upon the relative merits of the proposal, as compared with possible

alternatives, as a permanent instrument of fiscal policy. What is recommended for a special and temporary reason would be attacked and defended on other and more far-reaching grounds altogether.

17. I question, in the second place, whether a tariff would not result in a spurious equilibrium likely to cause a new series of disequilibria in the course of time. In general, the beneficial effects anticipated could only follow if the reduction in real costs were effective. An attempt to adjust the level of costs, especially wage rates, to the effect of a rise in the cost of living, would at once produce new disequilibria. But, apart from its intended effect in assisting British industry to replace competitive imports by British products (which would assist employment) it is claimed for the measure that it would help in reviving business confidence and the "spirit of enterprise". But in order that it should have these effects, it is not enough that it should create a temporary mood of optimism, to be dashed later on by the failure of the tariff to function as it was intended to do. If, as a result of the imposition of tariff duties, a sharp fall in the volume of competing imports takes place, and the volume of foreign investment is not adjusted to the change in the position of the Balance of Payments, gold would flow in freely, to be utilised to serve as the basis of an expansion of credit.

Thus, if the tariff is at all successful in achieving its objects, it seems reasonable to suppose that it would result in a temporary boom in home industries, and that, under these circumstances, a check would be given to foreign investment, at least for the time being. In the early stages of revival, the Central Bank might find it difficult to offset gold imports by sales of securities, for it would then be liable to be attacked for running counter to the policy of the Government of the day in restoring "confidence", and the anticipated effects upon the volume of credit are, therefore not only possible, but, under the circumstances, not improbable.

The money-income of society would thereupon expand: especially if diminishing unemployment and rising prices led to a rise of money wages. Thereupon, at the new level of money-incomes (the tariff being supposed to remain unchanged) a new stimulus to imports and check to exports is brought into being, and a new disequilibrium between domestic and foreign costs is set up: to be followed either by the collapse of the boom or the imposition of a still higher level of tariffs in order to avoid the threatened breakdown of "confidence". I agree that the question can only be answered definitely by a comparison between particular, alternative projects. A slight measure of tariff protection would necessarily have slight effects. But this would apply to the beneficial, as well as to less attractive, consequences to be expected from the imposition of import duties.

18. Thirdly, I believe that the proposal for a tariff upon all imports accompanied by a subsidy upon all exports would prove hopelessly impracticable, and that the effects of any tariff which would be likely to be imposed would differ markedly from those which, it may be held, would follow from a flat rate of import duty accompanied by a flat rate of subsidy. My belief is not based merely upon the circumstance that, if such a flat-rate tariff and subsidy were imposed, it would be met by countervailing anti-dumping duties in foreign countries and that, in order to avoid the danger of the application of such duties, equivalent advantages to the export industries would have to be devised, the subsidy being dropped in favour of such alternatives. I do not think that the technique of tariff-making is so little understood by foreign countries as to make it at all difficult for them to apply special measures against British goods, merely because we would attempt to grant our export trades concealed, instead of open, bounties.

The main object of the proposed tariff is not to collect revenue but to counterbalance the disadvantages of the British level of costs, as well as to keep out part of the existing imports of goods. But I feel that Parliament would not view with any great favour a scheme of tariff legislation which, whilst it would involve, in all probability, very considerable administrative expenses, would not have the advantages of leaving a large additional net revenue in the hands of the State. In combination with a subsidy, which would make an additional volume of exports possible, the revenue aspect of the proposal is hardly worth taking seriously into consideration. But this would diminish the practical attractiveness of the proposal very much.

19. The probability then is that the tariff as introduced would depart from the postulated simplicity of form and purpose contemplated. Though this is not the place to discuss at length the advantages and disadvantages of Protective Tariffs, it is not straying beyond the limits of the permissible to point out that the more complex and elaborate the tariff, the less can be predicted, in the absence of definite knowledge of what the concrete details are, of the effects of a tariff upon the position of the export trades. In considering the effects of the imposition of a tariff upon exports, it is not enough to take account of the direct reactions which might be expected to result, but attention must also be paid to the indirect reactions. Foreign goods excluded from the British market do not simply disappear; they reappear, in the guise of increased foreign competition, in neutral markets. The net increase in employment under all heads which will result from the imposition of tariffs is therefore likely to be smaller, and the damage to the export trades greater, than appears at first sight. The trade of the world as a whole, of course, is not a fixed magnitude, and it by no means follows that in the long run neutral markets will not be in a position

to absorb both a greater amount of British goods and of the goods of countries directly competing with ourselves. But if this argument is valid, it is also valid to argue that an increase in the imports of manufactured articles into this country is not inconsistent with an increased demand for domestic products, in the long run, provided the productivity, and therefore the consuming power of the country, continues to increase.

The Problem of Costs.

20. The only alternative which has not yet been discussed is a reduction of costs. Since cost reduction is inextricably mixed up with the question of wage levels, both absolute and relative, and with the question of the standard of life of the population, it is inevitable that this issue should be one which rouses some unintentional, and perhaps as much interested and calculated, misapprehension. I propose to set out the issue as succinctly as possible.

(a) The problem arises partly because we may not have increased our efficiency in the last ten years as rapidly as some of our competitors; partly because we had not, even before the world slump, entirely overcome the disadvantages attaching to the choice of ratio at which we returned to the gold standard; partly because world prices have fallen heavily since. It is very natural that producers, both employers and employed, should resent the imputation that the whole of the problem of adjustment is due to faults originating on their side: that it is entirely a question of deficiency of organising skill, and of productive capacity. But it does not follow that additional efforts and sacrifices may not now have to be called for.

(b) A reduction of costs is not necessarily tantamount to a reduction in wage-rates, still less of money-incomes. What is required is a reduction of cost *per unit of output*, and such a reduction may be quite consistent with rising money-incomes. Thus the workers may be right in insisting that a reduction of costs should not take place uniquely at their expense, through wage-cuts and nothing else. Our methods of organisation, salesmanship, the choice of leadership, etc., are all elements over which Labour has little direct executive control, but which are extremely relevant to the problem of cost-reduction. Still, if costs are to be cut by improved organisation and technique, it must be borne in mind that the Labour movement must contribute its fair share to the solution of the problem. Public attention is largely concentrated upon wage-issues, but there are other elements in the situation as well; insistence upon the maintenance of practices and regulations which have the direct effect of keeping costs up. If Labour desires to cut costs and refuses to allow wages to alter, it must at least be willing to alter practices which increase per unit cost. It can hardly be asserted with truth that this has always been the case.

(c) If it is urged that "finance" must contribute its share to the burden of cutting costs, the answer is that through conversions and reorganisations the fixed capital involved does have its remuneration reduced, whilst the owner of equities gets nothing, or gets less, unless and until profits begin to re-emerge.

(d) It may be argued that, if the cutting of costs leads to a fall of prices, and British goods can again be sold at a competitive level, profits will not re-emerge, i.e. purchasing power will be destroyed and not re-distributed. But an increase of sales which permits of a reduction of overhead costs on the whole of the output may still be consistent with the emergence of profits.

(e) It is argued that not only labour-incomes, but all incomes, have benefited, in terms of real purchasing power, from the fall in foreign prices relative to our prices. This is true, but if it is used as an argument against a possible reduction of wage-rates, it is invalid. For the level of money-wages may be too high to permit of full reabsorption in other directions. The gain through the alteration of the terms of trade in our favour involves a transfer of labour into alternative occupations, and, if it is to be absorbed in these occupations, labour may have to accept a lower marginal wage, because in those other occupations, there has not been a shift of the terms of trade in favour of the British seller.

(f) Whatever reduction of wages and salaries may ultimately prove to be necessary, it by no means involves an equivalent reduction in the standard of life. A 10 per cent. wage or salary reduction is not equivalent to a reduction of real income of as much as 10 per cent., even if other costs do not fall.

(g) If no wage and salary reductions take place and unemployment expands, a point must come when working-class purchasing power as a whole will be less, given a certain combination of employment at given wage rates plus unemployment at a certain rate of unemployment pay, than it would be if wages and unemployment were both lower.

(h) There is nothing in the fact of wage or salary reduction which implies that wages and salaries can never be raised again: or that an immediate wage reduction implies a *permanent* lowering of the standard of life of the bulk of the population. The standard of life of the world, and of particular areas, is governed in the end by productivity, and there is every reason to suppose that, highly organised as the Labour Movement is almost everywhere in the modern world, successive increases in productivity will be reflected in a rising standard of life, as has indeed been the case throughout the modern industrial era.

(i) The view that a reduction in the price of British exports due to wage reductions would be nugatory, because such reductions would simply force on equivalent reductions elsewhere, is not in accordance with the facts. Such wage reductions as are taking

place—some at least on a scale which suggests that not all the organised workers in the country are entirely beyond being appealed to in these matters—have followed and not preceded reductions elsewhere. Moreover, it is not necessarily the export industries themselves which should suffer any reduction of wage rates, but the ancillary and sheltered trades whose wage rates and standards have been maintained at the expense of the standard in industries less able to protect themselves.

21. There is no reason to suppose that this country has exhausted the possibilities of rationalisation, using that word in the largest sense: and it may very well be the case that, in order to push on as fast with rationalisation schemes as the urgency of the situation requires, intervention by the State, both in the way of arming an industry with statutory powers and by way of guarantee, may be required. But—even in the absence of a catastrophic alteration of world prices—such schemes may not prove enough: and some alteration in the scale of wage rates may be necessary. Those who do not wish to see wage rates reduced, or who think it impossible to do so, in the main urge measures which will have the same economic effect—the imposition of a general tariff. Indeed, unless the tariff does have this effect, it will not be a solution of that aspect of the British economic situation which concerns the members of this Committee.

22. It is true that a tariff, *if successful in reducing the standard of life all round*, would hit classes of the community who would not only not be affected unfavourably by a reduction of costs, but who would gain from such a reduction. That wage-earners should dislike wage reductions at a time when it can be plausibly argued that the rentier gains is no doubt perfectly natural, even though the economic depression has much reduced the value of investments in industry, and even though among the ultimate beneficiaries from the rise in real value of the National Debt are the working-class members of Trade Unions, Friendly and Building Societies, etc., owning blocks of War Loan. But the problem confronting us is one which cannot be settled on emotional grounds alone. The difficulties in the way of special taxation of the rentier are very great. But it is clear that any considerable reduction in the money value of the National Income must involve increased direct taxation to meet debt charges, unless a successful large-scale conversion operation can be undertaken in the near future. Such increased taxation (the basic rate of Income Tax having already risen in recent years by 12½ per cent.) will fall in the main upon rentier and contractual income, and constitutes an offset to any increase in non-working-class well-being due to reduction of prices and costs, which would not, if money wages fell, accrue to those dependent upon incomes from labour.

23. In the course of the last decade we have become, as a nation, highly sensitive to considerations of equity as between class and class. At the same time, partly in consequence of our desire to translate our ideas of equity into practice, our economic and social structure has become less fluid and less amenable to change. To sacrifice elasticity to equity is tolerable so long as, in the outside world, changes are not proceeding at so rapid a pace as to make adaptation on our part, even if only with a time-lag, ultimately impossible. It may be that we are now faced by a turning point in the history of the world price level, to which, in the end, the level of costs in the outside world will adapt itself. If this diagnosis of the situation proves to be correct, it would be out of the question for us to maintain a level of costs out of all proportion to costs elsewhere. It may, on the contrary, prove to be the case that the world is now in the trough of an unusually deep depression, recovery from which will bring with it a renewed rise of prices. It is too early yet to say definitely which of these things will happen : but it is clear that a world rise of prices would greatly mitigate the severity of the task which would otherwise confront us. So long as the present degree of uncertainty as to the future level of prices prevails, to defer action, in order to take thought, is perhaps legitimate. But to defer action simply because we are as a nation afraid of acting at all would be a confession of moral weakness, neither creditable to the traditions nor beneficial to the economic future of the country.

T. E. GREGORY.

ADDENDUM IV.

1. As the result of the construction which has been placed upon the terms of reference the question of how Industry could be re-organised, reconditioned and financed has not been touched upon in the Report. In consequence the evidence which has been received on behalf of Industry has been singularly deficient in constructive proposals which might suffice to place Industry once more on a sound financial and competitive basis, and this deficiency is observable particularly with reference to those branches of Industry which rely to a large extent on their export trade. It was reiterated by most witnesses representing industry that costs of production were much too high, that reductions could be brought about, and that the trade of the country could be retained if not regained (i) by an increase in the efficiency of both employers and employed, (ii) by an all-round reduction in salaries and wages, (iii) by the setting up of a general system of tariffs. But no evidence was received as to the effect which all or any of these vital proposals would have either on the cost of living or on the cost of production

or on the export trade. The process of rationalisation is now well advanced in certain industries but this process cannot be successful without a clear conception of what is being aimed at and how it is to be achieved. And if this process is to be continued and even accelerated it is of the highest importance to consider how it may be affected by the adoption of the proposals (ii) and (iii) and what under altered conditions may be the results of the process in the transitional stages of re-organisation. It is difficult to see how these three proposals or any of them could be accepted or acted upon without the most careful investigation.

2. It undoubtedly is the case that defective methods of distribution and the want of adaptability in some trades have been factors contributing to the loss of the export trade no less than high costs of production. The need for a concerted plan in dealing with each trade or certain groups of related trades was never more apparent. If it is by mass production, by careful and systematic investigation of our markets, by reaching the consumers and knowing their needs that the bulk export trade is to be won back, then all sections of each particular trade should be linked up so that production could be concentrated in the works best equipped for the purpose.

3. So long as industry delays in adapting its selling and distributive methods to the new circumstances of world trade, so long may we expect to lose ground in the world markets. In these circumstances new capital necessary for keeping plant up to date, apart altogether from expansions, will be unobtainable, and without up to date equipment there is no hope of competing on equal terms in overseas markets. And so the vicious circle will continue.

4. The only hope of the necessary investment on reasonably low terms depends in many industries on the assistance of some form of State guarantee. But the State in the interest of its own financial responsibility, and in the interests of the trade concerned, should make its assistance dependent on rapid re-organisation. The guarantee of a whole trade linked up for a common purpose is far more secure than that of particular enterprises whose power to repay may be destroyed by the unfair competition of enterprises hard pressed for ready cash in their own locality.

5. The leaders of the Trades Unions should be brought into much more active touch with employers in the process of re-organisation and so increasingly to understand and appreciate the difficulties with which employers have to contend and the urgent necessity for greater efficiency.

6. Greater efficiency, however, is required not only in the workshop but in the office and the board room, and the leaders of the Trades Unions ought to be able and ought to be encouraged to promote such efficiency by pointing out what they regard as causes of friction and loss of energy and to make suggestions for their

removal. Employers often overlook the fact that the workers in a trade are as much concerned to promote its prosperity as they themselves.

7. By such co-operation it should be possible to build up a live machine which would be able to devote itself to retaining and regaining trade instead of dissipating energy in perpetual disputes on questions of wages and conditions of work.

8. While I venture to express my regret that the scope of the inquiry was held to exclude an examination of the probable effects on finance and industry of proposals to which I have referred, I am conscious that this is not the place in which an individual member can fittingly attempt such an examination and subject to the foregoing comments I am content to sign the Report.

L. B. LEE.

RESERVATION BY SIR T. ALLEN AND MR. BEVIN.

We join in signing the foregoing Report in the belief that its recommendations tend to alter the direction of our monetary system from the basis of a contractionist policy to one of expansion, but desire to make the following reservations on certain items.

With regard to the terms " money costs ", " wage costs ", and " wage rates ", which are mentioned in various paragraphs of the Report, we may state that the Committee had no opportunity of examining any evidence on international wage costs, so that no real inference can be drawn as to money costs in the different countries, merely from the figures of actual time rates of wages.

On the other hand, we take the view that insufficient emphasis has been given in the recommendations to other money costs, particularly the effect of the dead-weight debt. Evidence was given that the effect of this is such that where in 1911 for the National Debt internal interest alone industry had to find £16 millions per annum, it now has to earn and hand over to the State £277 millions. while other fixed charges on industry have increased in like proportion.

At the same time the State, Public Authorities, and Public Utility Bodies have had to incur fresh debt on the construction of public work as a consequence of the depression and the failure of private enterprise to keep the workers fully employed. Hence it will be seen that Management and Labour are called upon to bear a burden almost too great for them, especially having regard to the falling price level.

We disagree with the recommendation in paragraph 202, page 90:—

“ Nevertheless it would appear as if a most important consideration for those in charge of the public revenue to bear in mind, so long as the future course of prices is uncertain, is the avoidance of any form of obligation involving a large addition to the contractual obligations of the State.”

We take the view that any such recommendation would render impossible any solution or easement of the unemployment situation and would hold up such necessary internal work as Housing, Slum Clearance, Public Work and other schemes as mentioned in Addendum I.

In fact, private enterprise having proved totally unable to lift the country out of the morass in which it is, there seems no alternative but for the State to grapple with the problem and for large measures of State planning, which must involve further contractual obligations, to be adopted.

We also desire to point out that the Committee decided to examine monetary policy only on the basis of the gold standard and, therefore, no alternative to the gold standard was examined or discussed; but we take the view that, if it is found impossible to give effect to the recommendations on international policy (paragraph 251 and Chapter II, Part II), owing to unwillingness on the part of the countries concerned to co-operate, a point may be reached when this country may be compelled to go off the present form of the gold standard, and we take the view that the Treasury and the Bank of England should be considering an alternative basis in order to minimise disturbance if such a contingency should arise.

In regard to paragraph 281, we are firmly convinced that the great powers which the Bank of England already possesses, and which are contemplated should be developed more fully in the future, ought no longer to be left in the hands of a body which is in form a private profit-making institution, even though in practice it acts as if it were a public body. From the point of view of popular confidence, which is so great an element in these matters, we are convinced that the Bank of England ought to be transformed into a public corporation. While it should remain free from political influence, its Governing body should not, even in form, be representative of private stockholders, nor should its membership be drawn very largely from one financial group. We think the minimum change required is the appointment of the Governors by the Crown, the establishment of an Advisory Council representing industry, commerce, etc., and the transformation of the stock into fixed-interest bonds.

With reference to the recommendations in Part II, Chapter IV (paragraph 403), we join in the recommendation for the creation

of new machinery for financing industry, but strongly recommend that, instead of being a private institution, it should be a public corporation.

THOS. ALLEN.

ERNEST BEVIN.

RESERVATION BY MR. LUBBOCK.

I have signed the Report, with the following reservations :—

(1) With regard to Chapter III of Part II in particular and also to other portions of the Report which relate to the Bank of England, I refrain from expressing assent or dissent, because, while I have shared in all the Committee's discussions, I have felt that it would not be proper for me, as a Director of the Bank who has been closely concerned in its policy and administration, to be a party to any conclusions or recommendations affecting the Bank which it may be my duty hereafter to consider in my capacity as one of its Directors, and with regard to which it may be that my position has disabled me from taking an entirely impartial view.

(2) By the terms of our reference we were limited to the consideration of Banking, Finance and Credit, and it is only with regard to these questions that the Committee can make recommendations : but I do not fully share the hopefulness indicated by some passages in the Report that some form of positive action on the part of those in control of Banking and Credit would be effective in relieving the present economic depression. " Banking action necessarily follows, not leads. Industry " (Clay §25); and while the monetary machine must do what it can to open the way for a revival of our Industries, it is in other (non-monetary) directions and by other means that the conditions of such a revival must principally be sought.

CECIL LUBBOCK.

RESERVATION BY MR. NEWBOLD.

1. Whilst concurring generally in those chapters which are purely descriptive of the existing monetary situation and of the features of the post-war world as set out in the Majority Report, I do wish most definitely to declare that neither in the evidence presented to us nor in the deliberations within the Committee has it been proven to my satisfaction that either the difficulties peculiar to this country or those experienced by the world at lar

can be attributed in the main to monetary causes. Further, I wish to dissociate myself from the opinions implicit in the arguments of my colleagues that this complex crisis has resulted from some inexplicable variation from the normal functioning of what they call the economic system. Rather do I regard the *impasse* at which has been arriving every country wherein prevails the economy of commodity production and marketing as the inevitable consequence of the operation of principles whose finally irreconcilable character has only been made visible when they have become not local and exceptional but world-wide in their application. The theories which my colleagues have brought to bear upon the mass of material coming within the purview of this Committee have borne at every stage the stamp of their origin within an age and an environment wherein it was taken for granted that the whole world responded or reacted to the ordered rhythm of the classic finance, commerce and industry of this country. Always, the gold standard game has been regarded as only properly to be played to the rules accepted in London. That others should have adjusted it to what they regarded as the requirements of their agriculture, industry and commerce has been treated as if it was a grievance. The approach to the whole problem has been insular, as if the objective to be attained was the restoration in this country of conditions for everyone as far as possible akin to those of a nationally exclusive past rather than of an internationally inclusive future. At the same time, as could only be expected of those who think within the limitations of an economic system wherein the prime motive is the making of a profit, the minds of the majority of the Committee have sought always a measure of relief for those categories of income rendered most rigid by the necessity of maintaining "the sanctity of contract" by recommendations that, if they mean anything at all, mean the drastic reduction of wages and salaries. This is a measure to which, equally in the nature of things and not because of any conscious conspiracy, is turning the employing class of every country. Failing that co-operation between them which, save under the panic impression of the superiority of the State-directed competition of the Five Year Plan, they find it so distasteful to adopt, this process of ever reducing the real wages of the working class is something which will be continued indefinitely. But now that the debtor countries are being subjected to the same insistent demands for a reduction of their standards of life, e.g., Australia, Brazil, Germany, etc., in order that the creditors may not suffer, the crisis is in a fair way to become chronic. In such an event nothing but obstinacy can blind us to the fact that the whole economic and social structure of a country such as this, organised over generations with a view to world-wide commerce, is in imminent peril of complete collapse. Organised with a view to world-wide commerce this country may

be, but for a commerce which was not competitive with others and which has in its every participant a prejudice or, at any rate, a predisposition against abandoning his own independence and co-operating otherwise than on paper with his compatriots. Such considerations are, I contend, if non-monetary in character, yet as essential to the stating of the problem as the numbers and conditions of our unemployed population. The mere fact that the "pressure of unemployment in an industry as an instrument for persuading men to accept wage reductions is made much less important than it used to be" by reason of the unemployment insurance system, as urged by Professor Pigou and that, thereby, the edge is taken off the internal operation of the bank rate, doubtless determined the majority of the committee to give so much attention to these matters. But an alternative item in the special problems of Great Britain I suggest, with all due respect to my colleagues, is the backwardness of the technique and management and salesmanship of industrialists and traders which causes them always to seek at the expense of others, be it the Bank or the wage-workers or the unemployed, the economies which they cannot see how to make in their own expenditure, whether in or out of business hours. There is in every class in this country an attitude towards individual expenditure which, however appropriate to the conditions of a world wherein its industry, its commerce and its finance were virtually unchallenged and unchallengeable in their self-sufficiency, is now a national danger. Savings urgently needed for the replenishment of the capital requirements of industry and commerce can be and are dissipated not only by the drawing of these into and through the Treasury to be paid out to the recipients of what are erroneously called social services to expend at their own discretion, but just as much by the direct uneconomic outlay of individuals. The right of the latter to do what they like with their own is equally anti-social and contrary to the interests of the nation if advanced by a workman or a rentier. Resistance must be put up relentlessly to the argument, from whatever angle offered, that a greater part of the national increment shall be made available to or retained by the consumer. Whether the capital accumulations are directed into reproductive channels by private or public authority is not the direct concern of the economist. That is for others to decide, not for the members of this Committee.

2. The tendency in the world is towards some or other form of planned economy. That is determined by three prime considerations. The first is, no doubt, a reaction from the altogether temporary ecstasy of *laissez-faire* that prevailed in the interlude between the breakdown of a society rooted in agriculture and the development of another based on industry. The second results from the recognition of an evident necessity to adjust the relations, internally as well as externally, of economic entities which

do not exist any longer *in vacuo* as did England in the age of the Industrial Revolution. The third springs spontaneously out of the requirements of the new technique of power and transport. This latter being comparatively recent is still so novel to monetary theorists and practitioners—always in the nature of things tending to be removed as far as possible from realities—as to encounter from them a frank denial. But even if it is fantasy to the banker, to the engineer it is a fact.

And in this difference of outlook begins the difficulty of bringing into conjunction the banker and the industrialist. For the latter has evolved, in the age of the engineer, a complex of commodities which, as each has been swung into its place in the scheme of production, has lost its original economic character and become a value only under a certain set of circumstances. It has become so static as to have forfeited almost every quality of the commodity. It has ceased to be negotiable. It can no longer enter into exchange. Such being the case, the banker must regard it with extreme suspicion. For he has gone in exactly the opposite direction, evolving an ever more abstract equivalent of the commodities of commerce so that, even more than the merchant, he must endeavour to maintain his medium negotiable under all conceivable conditions.

3. The bankers' bank, which is the Bank of England, has therefore a duty to do that renders it functionally antipathetic to the immediate requirements of industry. Apart from its management of the National Debt, its receipt of monies of the Government and its issue of the currency—which latter services as is shown elsewhere mingle with its banking transactions—the Bank of England has as its particular rôle the rendering of a series of services not to industry but to commerce.

Its long-term investments must have the negotiability of assets guaranteed by Parliament or public authority or public corporation of unimpeachable solvency. Its short-term investments must have equally the exchange value attached to the most impeccable commercial paper.

Historically, the Bank guards the subject against the fraudulent default of the Crown in its engagements to restore borrowed monies intact. So, also it has not ceased for centuries to safeguard him against that abuse to which is prone all sovereign power—the debasement of the currency.

This latter is the invariable expedient of the spendthrift. From it result most of the evils of this present day in so far as these are attributable to monetary causes and which must ensue from either such a condition as prevailed during and immediately after the War in all belligerent countries or as recently existed in the United States.

4. It is in my judgment inherent in certain of the proposals made in the Majority Report. Subject to the unceasing criticisms of its credit policy when no longer acting in accordance with parliamentary statute, it will be very difficult for the Bank of England continuously to resist the pernicious counsels of inflation. The abandonment of the gold standard being recognised as something which, directly demanded, would be rejected outright, the eventual attainment of this objective is sought, like certain other oblique attacks on the wages of the workers, to be obtained by these indirect means. If reductions in the wages of the workers are unavoidable, then we will have them made in honest money. At least, we wish to know where we are and not to be made the victims of that supreme confidence trick, a price index to be compiled and corrected according to the conflicting estimates of a committee of economists whose minds would invariably be in a state of unstable equilibrium. The bias which is as visible as it is unwitting in the whole method of approach of the theoretical supporters of the existing economy, makes it impossible for the workers or their representatives to trust their rates of remuneration to a method of adjustment that is so subjective. That fact, taken together with the inadequacy of economic science, makes it essential that the measure of value shall continue to be as nearly as possible automatic. This automatic character indispensable in the measure of value is attained most completely by gold. To this latter material belongs the peculiar quality of attracting and retaining over very long periods of time a socially necessary quantum of labour substantially invariable. This quality formerly possessed in considerable degree by a second metal, viz., silver, has been forfeited by it during more recent years with the result that it has become desirable to take formal cognisance of an actual change and all the world over to arrange for its de-monetization.

5. The changed conditions of metalliferous mining which have resulted in the enormous increase in the output of silver, since it is brought to the surface in the same complex ores as the zinc and lead in such immense demand as base metals of modern industry, have made this step, so disastrous for the owners of hoards of that metal in China and India, eventually unavoidable. But, in view of the known fact that so great a superstition attaches itself to the subject of the monetary media—whether metal or paper—as often to assume nothing less than the grossest form of fetishism even in countries of high economic and cultural development, it is open to question whether the decision to implement the demonetisation of silver was made with the necessary caution and tact. The same disregard of the interests and beliefs of others than the monied magnates which marked the return to the gold standard in Europe has characterised its adoption in Asia. So, in both continents have the final arbiters of economic and, consequently, of political power aggravated the unrest already result-

ing from industrial and agrarian revolutions of the most unsettling character. Now, as in preceding centuries, the development of trade and, in its train, of industry is conditioned by the volume, the velocity in circulation and the unvarying value of the monetary media. Such being the case, the opening up of China and India necessitates the adoption of a sound and stable currency and the establishment of a banking system similar in character to that already existing in Europe and America. All the more urgent is it, therefore, that as little prejudice as possible shall be aroused in East as well as in West against a machinery that is absolutely essential to civilised society.

6. In view of the recognised relationship between the difficulties in the Eastern markets and the collapse of industry and employment in this country, as also to no small extent in Central Europe, I have no apology to make for labouring a point which I believe my colleagues have most unhappily avoided.

7. Returning to the main theme of the gold standard, I wish to dissociate myself entirely from the viewpoint of those who regard our difficulties as due to the inadequacy or even the maldistribution of gold. These supposed causes are themselves merely phenomena resulting from factors far more fundamental. Gold is but the objective basis whereon can be reared, so far as the subjective factor of confidence permits, an edifice of monetary media equalling the sum total of the mass of values existing within any given area within which those media circulate. The subjective factor of confidence is at least of equal importance with the objective factor of gold. They vary in inverse ratio to each other. Credit was the creation of the years during which peace between the nations of high commercial development and within the nations of high industrial productivity was virtually undisturbed. Credit was an expansion of the monetary media which radiated outwards from the centre of the most stable State and, as time went on, encountered and inter-mingled with similar if less vigorous emanations from the centres of such States as had adopted as the measure of value and the standard of price the same objective reality—gold.

8. The subjective factor of confidence has become since the outbreak of the Great War a variable and ever more uncertain quantity. The destruction wrought by the actual conflict as well as the disorganisation of commerce and industry caused by the severance of trade connexions and the diversion of capital and labour to employment of little economic value, was aggravated by the altogether reckless distortion of currency and credit all of which left an appalling legacy of deceit in the guise of internal indebtedness. Then, as the incompetence and ruthlessness of governments became utterly intolerable, there ensued revolutionary movements which, together with the disturbances of the normal economic intercourse perpetuated or provoked by the Peace Treaties, caused a

flight of capital from one after another country of Eastern and Central Europe. The efforts made to stabilise the new States as well as to repair the damage done to the financial fabrics of Austria and of Germany have all been futile. The whole crazy improvisation is in imminent danger of collapse.

9. In this intensification of the chaos which is the normal condition of capitalism, there has occurred a continuous, if by no means constant, dislocation of industry in the creditor as well as the debtor countries. Wages have been driven down, employment has been disorganised. Simultaneously, the resolve of the United States to avoid internal conflicts calculated to shake there, also, the edifice of an economy jerry-built about a skyscraper of credit, has led to the restriction of immigration. So, there has been no outlet for the surplus labour of the Old World.

10. It has been necessary, therefore, to find the money to maintain the mass of workers who could not be employed at a profit. This money can only be raised, at any rate immediately, from those who have a surplus over and above what they need to maintain themselves and perpetuate the profit-making species. In such a situation, widening since the autumn of 1929 until it has come to coincide with well-nigh the whole world, it is absurd to lay the blame for the crisis upon a mere measure of value. It is not gold which is scarce but confidence which has fled.

11. Even more absurd, if anything, is it to pretend that by the erection of still more obstacles to the free flow of commodities any nation requiring to supplement its native resources by means of imported food-stuffs and raw materials, as does ours, can do other than intensify the chaos from which, as an economy organised to produce for export, we stand more than any other on the whole planet to suffer.

12. In view of the fact that the industries of this country, apart altogether from those obviously producing primarily for export, have been operated for years, for decades and, in some cases, for generations to supply the needs of shipping, of shipbuilding, of railway communications (almost invariably promoted to feed one or other of the great ports), and of the equipment of the works and the foddering of the workers engaged in export business, nothing but an invincible ignorance of the economic history of Great Britain can palliate the suggestion that we ought, otherwise than gradually, and working to an agreed plan, to substitute a home demand for an overseas trade.

13. In the latter, also, this country has developed a financial as well as a commercial connexion and an aptitude for the exchange of commodities and the furnishing and supervision of credit facilities which, employing no inconsiderable part of the population,

constitute at the same time services of which the whole world has need now and will continue to have indefinitely far into the future.

14. In the retention, the improvement and the extension of these activities, needing less the investment of huge aggregations of capital than the ever more expert activities of the human element, I would strongly urge my countrymen to seek the maximum gain from the highly individualistic character of the national genius.

15. Since, however, an active commerce cannot continue to exist apart from a vigorous industry, it is necessary that the latter should be able to hold its own with industry in other countries whose original lee-way of technical inexperience, capital insufficiency, political insecurity or geographical inequalities is now being rapidly overcome.

Again, special aptitudes for the production of articles of enduring quality suggest that more emphasis should be laid upon the training and equipment of the national labour force than upon the reduction of its wage rates to the level of a labour force recruited rather for low-grade production.

16. It is eminently reasonable to infer that so soon as the mass demand of the world has been met for articles of indifferent finish and unimaginative uniformity—a proceeding not likely to be very long deferred should the world be enabled by its creditors to escape from the present *impasse*—there will arise an ever greater and greater demand for articles of more marked individuality than standardised industry can produce. It is such a market which we must maintain our disproportionately numerous craftsmen and tradesmen again to supply.

17. The temptation to yield to an entirely ephemeral preference on the part of our overseas customers for the articles of crude workmanship and indifferent finish is one which must be decisively rejected.

18. That being so, alike abroad and at home, it is essential that the banking institutions, subserving the needs of a highly individualistic commerce and a specialised rather than a rigidly standardised industry, shall attain in their *personnel* a ready adaptability to continuously changing conditions of trade rather than that they shall be required to immobilise vast credits in the finance of grandiose plans for reconquering markets in Latin America or securing a substantial share of so unsubstantial a demand as offers in Soviet Russia.

19. Liquidity of assets is so paramount a necessity for banks of commerce that it is impossible otherwise than emphatically to reject counsels, from whatsoever quarter they come, which would have as their consequence the ear-marking for years ahead

of such revenues as might or might not result from so many superficially attractive propositions as have been dangled before us.

20. This same consideration causes me to view with no less distrust the continuance on the boards and, may be, in the management of the joint stock banks of a *personnel* so obviously drawn from families, traditionally associated with the constituent firms by the amalgamation or absorption of which "the Big Five" and the several more provincial banks have swelled to their present impressive proportions, linked altogether too closely in blood relationship and in business connexions with great industrial enterprises urgently needing to be subjected to what Sir Josiah Stamp described as "a few healthy bankruptcies." I cannot rid myself of the feeling that much of the criticism levelled at the Bank of England by the spokesmen of the industrialists and their friends among the joint stock bankers is motivated by such "unmentionables" as the frozen credits of the boom years of inflation.

21. The volume of overdrafts which, in the event of a general movement to liquidate the cotton, woollen, coal, steel, shipbuilding and certain other industries one after the other, if not all at once, would be discovered to be as rigid as the Greenland ice-cap, the wary answers of witnesses coming before us from the joint stock banks made abundantly evident. To be brutally frank with the critics, let me say that the suppleness and ingenuity of their argumentative methods have in no sense detracted from the impression made on my mind that their real grievance against the system of credit control exercised by the Bank of England is that it compels, as an alternative to extinction, an accommodation of industrial, commercial and banking practice to the conditions of a world economy that will not wait upon the customary convenience of England.

22. Exposed, the one much more and the others much less immediately to the buffets of the external money market, after all these years of experience, it ought not to be beyond the powers of the Bank of England and the banks of commerce to adapt themselves to an epoch of economic change which, far from approaching an end, is only at its very outset.

Either those in control have not yet felt to the full the discomfort and distress which, in ever widening circles, sweep upwards through the rest of society or else these people, highest and, therefore we may assume, oldest in the hierarchy of capitalism, are in the economic sense so senile that they are incapable of evolving any new ideas of practical utility.

23. Since no new form of organisation can properly take its place on the stage of history until that out of which it springs is already outworn, there can be no question of substituting the present controllers of the credit system so long as they can satisfy the reasonable needs of the public.

But the latter cannot tolerate indefinitely the continuance of those mutually exclusive poses which have, from 1826 onwards, in greater or lesser degree characterised the relations of the new banks, arising out of the Industrial Revolution and the old Bank, that has held on its haughty way ever since it was constituted to give permanent shape to the principles of the Whig Revolution.

24. Both of them continue to live, so far as practicable, in the past. So, not needing unduly to make a virtue of its necessity, I content myself with recommending to the banks of commerce the timely example of the Bank of England which has relegated the profit-making instincts of its stock holders to the rear, has selected its directors much more with a view to give expression to the several economic interests of the country than was formerly the case and is slowly but surely accustoming itself to the idea, altogether without precedent, that it should become the servant not of property alone but of the entire public.

For neither party can the change-over be easy. Each of them shares too much in the rigidity of mind and method that characterises a commerce and an industry which have so casually evolved over generations from such rudimentary origins as have those of Great Britain.

25. Here, in a measure equalled nowhere else in the world, the three forms of economy have grown up not apart from but inextricably entangled with each other. The merchant has been manufacturer at one and the same time that he or his nearer relations have been engaged in the business of banking. The entire economic structure of this country requires overhauling and to complain as querulously as many people continue to do that it is too big a problem is no more and no less than moral cowardice.

26. Immediately, however, my concern as a member of this Committee is with banking, finance and credit, and to that I am addressing myself when I insist that never must there be a repetition of the laxity, the favouritism and the general muddle which have marked the relations of the commercial banks with the moribund industries of this country since the end of the War.

27. Sir Josiah Stamp, answering Mr. Lennox Lee concerning the "great personal jealousies" in the business world, went on to say that "behind them are various banking positions of unknown degrees of solidity and jealousy . . . I cannot help thinking—this is only an impression of mine, and I am not able to back it up with statistics or facts—that the joint stock banks who are carrying the weak members should once and for all give up looking for better times for those particular members and also maintaining the priorities for their own benefit and keeping the beautiful position of their own balance sheet. They ought to precipitate

matters by pressing the debtors and making them deal with the situation." (Q. 4070-71.)

But "hard doctrine" as this seems to Sir Josiah Stamp, still harder must it seem to many of the hereditary banking dynasts whose votes count on the boards of the "Big Five" as well as in the ordinary and extraordinary general meetings of colliery, steel and kindred concerns in South Wales, on the Tees, around Sheffield and to the landward side of Newcastle, Glasgow and Liverpool.

28. The majority on these bank boards would do well, however, to note that whilst Sir Josiah Stamp said, replying to a question by Mr. Bevin as to whether by healthy bankruptcies he meant those of the banks, that the latter "are so strong that they can stand a good bit of it," there may well come a point at which even they may be pulled over. So soon as that point is approached it is probable that opinion will undergo a subtle modification and that, so far from it being insisted that "it is best to keep politics out," the responsible heads of the commercial banks will have discovered, as on other occasions, that there are limits to the risks that private enterprise can reasonably be expected to incur. But it is equally probable that opinion will have altered at least as much, if in an exactly opposite direction, so far as concerns the rôle of the state in relation to private enterprise suffering from the consequences of its own ineptitude.

29. This warning is perhaps the more necessary in view of the disposition shown before this Committee of bankers to expect the Chancellor of the Exchequer to be as reluctant to restrict borrowing by means of Treasury bills when they have difficulty in finding employment for their cheap money, as he should be eager to do so when the difficulty in finding employment is confined to the wage-workers.

30. At this stage it may be as well to remind the Bank of England that the wage-workers, constituting as they do the overwhelming majority of the electorate, are labouring under no unwarranted apprehension when they see in the raising or lowering of the Bank Rate a means deliberately designed and operated "to adjust" their wages. The possession of such a power by an institution, acting in complete independence of parliamentary control, is an anomaly which could not continue to exist in this country, side by side with popular sovereignty, were it to be exercised other than with an ever-growing discretion.

Unless it be that we are the least logical of people or that the exercise of this power rests with a man held in immense regard, there is no reasonable explanation to be offered for the perpetuation of a condition of affairs that flies in the face of common-sense.

31. But whilst, in principle, I agree with Mr. Bevin and Sir Thomas Allen that the Bank of England should not be an institution owned and operated privately, I am unable to see any case adequate for the change they propose in its constitution other than as an integral part of a carefully co-ordinated plan for such a fundamental re-organisation of our national economy as lies beyond the terms of reference of this Committee.

Already acting under Charter from the Crown and hedged about in their control of the currency by Parliament—from a whittling away of which control, as will be seen below, not they, but I dissent—so long as the Governor and the Court of the Bank of England continue to show themselves, in the essential spirit of our unwritten constitution, so eminently ready to adjust their methods to fit in with those of the Government of the day, I am not prepared to waste words over what seems to me to be purely a point of political theory.

32. At the same time I dissent, along with Lord Bradbury, from the proposed reform in the law relating to the note issue recommended by the Majority of the Committee. It is a relaxation of the control properly to be exercised by the Treasury (and so by Parliament) over the monetary attributes of sovereignty, from time immemorial vested in the Crown.

Robed in whatever fine phrases, supported by whatsoever specious reasoning, it remains a challenge presented naturally enough at this particular stage of social democratic advance to parliamentary ascendancy by the protagonists of private property ready, as soon as the State no longer reflects their interests, to push it to one side.

Collaborating, as it is ever more necessary that the Bank of England should, with the Central Banks of other sovereign States, it must not cease to be, in the final analysis, at all times *en rapport* with the Treasury.

Released from the legal limitations imposed upon its powers of note issue, extremely improbable as it is that under the existing control there would be any departure from the solid gold basis of the currency, the human factor alone would stand between the country and the possibility of inflation. There is no guarantee that another Governor might not reverse the policy of the present. The latter is probably strong enough a personality to stand up against the influences to which, in the event of the adoption of the Majority recommendations, he would certainly be ceaselessly subjected. But there is no guarantee that his successors will be as unbending.

In any case, I am at one with Lord Bradbury in regarding the proposed change as in the highest degree mischievous.

33. An expansion of credit is something that can only be embarked upon with safety to the extent that collaboration can be assured between the Central Banks. The bigger the reserve of

gold or the less the degree of uncertainty existing in and between the several countries the greater can be the amount of credit made available.

34. But the experience the world has had of the results of credit expansion in the United States during the last decade, when the powers of production have been developed without any effort at regulation other than by the rate of profit to be made over a very short period, should have afforded it a salutary lesson in the falsity of the quantity theory of money. Drawn thither by a number of forces, not least powerful among which was the desire of the propertied classes of Europe to evacuate the not inconsiderable part of their wealth that could, under present day conditions, be transferred abroad, the gold that poured into New York became the basis of a fabric of original bank credit which found embodiment in a technique of production capable of attracting to it a mass of labour-power that, despite the high level of wages, grew by leaps and bounds. Remaining in private control in the same way as had done the much less phenomenal gains of British manufacturers during the heyday of their prosperity, it found outlets of re-investment that were no more economically sound (or, for that matter, socially desirable) because they happened to be located at home rather than sought overseas. Put back into the businesses of the owners or made the basis of loans to others, the actual and anticipated profits of American capitalism in the twentieth century differed in degree rather than in kind from those of British capitalism in the nineteenth. That the collapse has been cataclysmic is to be explained by reason of those tremendous changes in technique to which, in his evidence, Dr. W. W. Stewart, former Director of Research to the Federal Reserve Board of the U.S.A., and, later, Adviser to the Bank of England, so continuously referred. The industries of to-day as distinct from those of yesterday are locked into great chains of production, process linking with process, so that finance has had, willy-nilly, to follow suit. The immobilisations of capital and of credit so demanded having been such as bankers are properly loath to make, the tendency in this, as in previous cycles of "boom" there and elsewhere, was for the pyramiding one on top of the other of ill-considered and ill-managed corporations given the flattering name of investment trusts.

35. The dire and long-drawn process of liquidation of all the multiplicity of crazy ventures—and not a few that did not even go crazy, but which have been pulled down in the common wreck—should, supposing it stops before it completes the ruin of an already war-shattered world, leave the tangible assets of the many in the effective possession of few enough financial houses to make their reduction and reorganisation according to something like a world plan of rationalisation possible.

36. Such being the obvious tendency consequent upon the continuous deflation of credit, hitherto available from banking as well as non-banking sources for the unregulated development of the world-wide production and distribution complexes made possible only by the most modern technique, it seems to me essential that whatever plans may be evolved in this country for the reconditioning of the basic industries should not run counter to this drift, ever becoming more definite and deliberate, towards an international economy. Since dominant political influences in all countries without exception reflect the passions and prejudices surviving from a dead past rather than any purpose in a living present, the more separate these new economic entities can be kept from the structure of the national state, here as elsewhere, the better. Whilst it appears, unhappily, all too probable that governmental compulsion will require to be applied in this country—and that quickly—to overcome the opposition and inertia of old-fashioned business men to what is called rationalisation (much better if brought about by the banks) and that a National Planning Council may become a necessary organ of the State, it would be calamitous that the basic industries of this country should be reorganised into national units with a view to make them ready to compete rather than to be co-ordinated with their opposite numbers in other countries.

37. Such a development must involve ever more rapidly repeated calls for new capital expenditure which, whether made by public or private enterprise, will come to entail an intolerable drain on the resources of this country.

Not once only will it be necessary to accept such recommendations as, with the commendable logic of capitalism, Mr. Brand is frank enough to make in his addendum, but again and again, as often as new funds must be attracted to or, at least, dissuaded from fleeing the country.

38. However, wages cannot be cut and social services slashed in this and in the way that Dr. Goldschmidt, of the Darmstadter und National Bank of Berlin, made it plain in his evidence (Q. 7345-48) he considered economically necessary, without provoking just such industrial, social and political reactions as have followed upon their adoption in Germany. They must, in their turn, affect unfavourably the credit, first of one country and then, as this desperate remedy becomes general in its application, of all countries.

39. Quite apart from the question whether this country can hope to command the resources necessary to retain a lead which it may have been found practicable for awhile to recover, the external repercussions of such an effort must be disastrous to the peace of the world.

40. The present opportunist drift in all parties towards an economic re-organisation either national or imperial in its loyalties must militate against the attainment of those conditions of stability with flexibility, alike at home and abroad, which can alone permit of the orderly because essentially automatic operation of the gold standard and of the credit system.

41. For that reason particularly desirable is it that the provision of the long-term credits necessary to re-habilitate British industry shall be entrusted to a corporation such as the Bankers' Industrial Development Company, the responsible heads of which are engaged in the finding of funds for similar enterprises in other parts of the world. Members of firms which are continuously figuring in consortiums of financial houses, international and intercontinental in their scope, for the collection and allocation of credits to re-organise and re-condition the basic industries and public utilities of many and varied countries are surely, subject to the checks appropriate to be provided by a National Planning Council, acting in consultation with the Bank of England, best qualified to undertake the task.

42. The actual range and method of the re-organisation of industry are no concern of this Committee except in so far as it is necessary to envisage the potentialities of the credit resources available to meet the demands that may be made upon them and to estimate the reaction of such long, intermediate, or short-term immobilisations of money on the financial fabric.

43. The urgency of improving the national trade balance does, however, require that consideration should be given to such alternative proposals as may tend in that direction. Whilst deprecating most strongly the adoption of either the expedient of a tariff of a general character, whether for revenue or protectionist purposes, or of a reduction in real wages and salaries, I would place the maximum emphasis on the need, if only as a temporary expedient during this period of acute national difficulty, for a revision on the part of everybody from the highest to the lowest of what have come to be customarily regarded *criteria* as to what constitutes essential expenditure. The dissipation of capital reserves, actual or potential, in the rendering of services or the manufacture of commodities which, whilst they may attract to the persons interested therein high wages and considerable profits, detract from rather than add to the productive capacity of the national labour force, is an extravagance which this country can no longer afford. It is monstrous that policies so calculated to dislocate our commerce as a revenue tariff, to disturb our industry as wage reductions, and to shatter our whole financial structure as a serious canvassing of devaluation, should be so much as listened to in advance of a nation-wide stock-taking of what individually, even more than collectively, we can or cannot afford. In

the event that no sustained initiative in this matter is forthcoming from those who are supposed to set the tone and give the lead to their less favourably situated fellow-subjects, then the same end must be sought by other and less agreeable means. Whether this shall be by taxation bearing much more heavily on income uneconomically expended, by drastic extension of excise duties or by a stringent limitation of imports contributory to the luxury trades, it will be for others to determine. However it is done, by voluntary action or by discipline enforced from without, steps must be taken without any further procrastination to encourage savings so that these may be made available for the re-conditioning of the basic industries and the transport services as well as for the provision of housing, health and higher educational facilities necessary to raise the intellectual no less than the physical standards of efficiency of the national labour force.

44. Going outside the terms of reference of this Committee as it would be to indicate the industries to which financial assistance might well be given, there is one exception to which it is particularly pertinent to call attention. Even as it is essential to reduce the volume of dispensable imports so is it necessary to increase the amount of exports. For this country there is a category of unusual importance, the so-called "invisible exports."

45. Amongst these is one capable of very considerable expansion, provided always, of course, that it is possible to throw off the lethargy and dispel the conservatism of those who are needed to make of it a commercial success.

The Tourist Industry has great potentialities, having regard to the romantic as well as the more nearly sentimental appeal of Great Britain and of Ireland to the more prosperous as well as the more cultured of the emigrant nations. But until much has been done to modernise hotel accommodation, to improve transport in the more picturesque parts and generally to cater for people who are accustomed to superior plumbing and a more rational system of interior lighting and heating—just to mention a few of the deficiencies—a revenue running into tens of millions sterling will continue to be lost to this country.

With the rapid falling away of our shipping prosperity, as well as the reduction of our overseas investments, this is a source of income which we can no longer neglect.

The constant presence in their midst of visitors from other lands across the seas may also prove helpful to the inhabitants in what a distinguished French economist recently described as "the Happy Valley."

J. T. WALTON NEWBOLD.

RESERVATION BY SIR W. RAINE.

1. After a most careful study of the Report and its recommendations I feel that it is too indefinite in its practical issues, consequently I consider I should express what I believe are some practical proposals for the improvement of the present position, because in my opinion it is useless to tinker longer with a situation which has every appearance of becoming even worse, unless we drastically alter our methods.

2. The Report has been largely devoted to a survey of our Financial Institutions, in order to show what important part they have played in developing British trade. It is true that in the Century concluding with 1914 the British people were so " busy " that the policy of *laissez faire* was readily accepted. It suited British psychology. The period since 1914 has shown the British people that the British system, which has worked so smoothly for them, requires revision; in fact, bitter experience has revealed the fact that had we taken earlier notice of some of the disadvantages we would not have found ourselves in the position we are to-day. The War, undoubtedly, exposed much which had before remained covered: there is no doubt also that the events which have followed in the last decade have so far as Great Britain is concerned revealed to us that, however good and efficient our system was, we must in the light of recent history adjust ourselves to the altered conditions, or the alternative will be that we shall be left behind.

3. Leaving aside the world slump which has affected everybody, the root of the trouble has been the re-division of Europe as the result of the Treaty of Versailles. Several small nations, which previously formed parts of larger units, are now working out their own destinies. The smaller nations wish to enjoy the same standard of living as hitherto. They found themselves in 1919 with legacies of war machinery, which were quickly converted into weapons of industry—new factories with up-to-date equipment. It must not be overlooked that Great Britain was not invaded during the War; Belgium and large portions of France were not only invaded but devastated. In the process of reconstruction these countries have obtained the most modern equipment. We being an older country were unable to quickly grasp the significance of all this new machinery; we were still very busy and wages were high. True we had various set-backs, but it can hardly be denied that the Ruhr trouble of 1923 again put this country in a false position; judging by subsequent events Great Britain would have suffered less without the monetary but doubtful benefits of inflated prices and booming trade of 1923. Had that not occurred, we should probably have come face to face with the realisation of the altered conditions before 1924, and with this great advantage to

ourselves, that the position would not have become so desperate as to cause us to grope almost in the dark to find a way out.

It is useless to regret what has gone, but rather, calmly and deliberately, to find a solution of the problems which beset our path.

4. Two factors require to be mentioned at the outset :—

(i) These new nations, in particular, have by means of Tariffs never hesitated to protect their industries, enabling their people to have constant employment—true at lower wages and on worse conditions than in Great Britain, which has permitted them to produce cheaply and to send us their surplus products at prices with which we could not compete.

(ii) Since 1925, we have only had on one occasion less than 1,000,000 unemployed, whereas in the meantime the Continent of Europe, as well as the United States, has enjoyed a period of almost unexampled prosperity.

These two facts, the second of which is really a corollary of the first, are worth careful examination.

5. The end of the War brought with it an ethical fervour in this country, which unfortunately had no solid foundation. Honest and praiseworthy attempts have been made by our people in all walks of life to bring about an international state of affairs, the results of which were intended to raise the standards of living of the nations, but for one reason or another success has not attended these efforts, and in particular in the realm of trade and industry.

6. In 1927 an International Conference at Geneva expressed the opinion that Tariff walls were too high. It is interesting to quote from the Report of the British Representatives. They stated that, "If other countries do not move towards a policy more in accord with the views of the Geneva Conference, a reaction from its traditional open market policy seems probable. It is believed there is a growing volume of public opinion in this country, which will not continue to accept without effective protest the present high tariffs and barriers which confront the British exporter." The reply to all this is that Tariff walls are higher to-day than ever before.

The present Government has made serious attempts to obtain reductions of Foreign Tariffs, but in vain.

7. Free Trade was undoubtedly the cause of the great prosperity of this country in the latter half of last century, but we are faced to-day with a new condition, inasmuch as the countries of Europe, and some in Asia, have reached a state of industrial development which carries with it a standard of efficiency in most respects equal to and in some cases superior to our own.

8. We have had some experience of Protection in this country from which it is safe to say that, were we to embark upon a regular system of Safeguarding, we should not be sailing upon an uncharted sea. Figures taken out of their proper setting can be made to prove anything, so I dismiss the statements as to whether in any particular year we exported more or less of any safeguarded article than before the trade in question was safeguarded, but hasten to look at the essential facts :—

(i) Are there more factories in this country producing say Motor Cars and Tyres than in 1925?

Have not some of these factories been built by foreigners as the result of Safeguarding? British labour is employed which means the wages are spent in this country.

(ii) Have not the prices to the consumers been reduced?

(iii) Are we not importing fewer of these commodities?

(iv) Are not more people employed in these and other safeguarded industries?

9. The forecast of the British Representatives to Geneva has proved to be correct. The volume of public opinion has grown which is protesting against high Tariffs that are preventing the free flow of our manufactures into other countries, whilst our open market policy enables these countries to send into Great Britain surplus manufactures at prices which in some instances would barely pay the British costs of labour. Bankers, manufacturers and even some economists who were traditionally Free-traders are amongst those who, whilst still theoretically Free-traders, now take the view that owing to the serious position in which we find ourselves some drastic changes are absolutely necessary.

10. I may add that an ex-Chancellor of the Exchequer recently addressing an assembly of business men stated that unless something is done at once this country will in the next two years become further embarrassed. The argument that imports must be paid for by exports is undoubtedly true, but how are we accomplishing this? Very fortunately for us, we, in our days of prosperity, invested vast sums abroad from which we derive annually some hundreds of millions of interest; we also render great services for which we are paid, such as shipping, banking, insurances, etc., but the policy of discrimination in regard to shipping has largely reduced this source of income and produced unemployment. Still further attempts in this direction are now being considered which will further curtail our revenues from shipping. Whether the calculations by which we arrive at the figures of our annual Balance Sheet are scientifically correct or not, the basis of comparison is more or less accurate, and the fact evolves that this account, which a few years ago showed an available balance for further investment of £150 to £250 millions, was last year only £39 millions. The

world slump had no doubt something to do with this low figure, but the naked fact remains that this process already described is proceeding with relentless certainty. It will find us before many years pass with a debit instead of a credit balance.

11. The Committee has been considering proposals to meet the present emergency. Summing up the situation I am forced to the conclusion that protection of our industries is essential and that it is necessary to state the fact in unequivocal language. I would limit the protection, however, at the outset to a Revenue Duty on **all** imported manufactured articles, which should be imposed immediately, the only exception being that the usual preference should be accorded to our Dominions. I do not minimise the difficulties of such a course, but I am reminded that this country is still the greatest creditor nation and we are the largest market in the world. Drastic remedies are required.

12. I do believe that such a remedy would, notwithstanding its difficulties, have the immediate effect of creating an atmosphere of confidence which would be the forerunner of a rapid improvement in trade.

13. I am not unmindful of the fact that exports are vital to the well-being of this country but I am convinced that our Dominions, as well as those foreign countries which have almost unlimited quantities of various food supplies, would be only too wishful to enter into arrangements with us for our mutual benefit. Besides, some of these countries as well as our Dominions must continue to supply us with foodstuffs in order to pay for the interest on and repayment of their indebtedness to us. Thus, if we did not arrive at the ideal state of Free Trade, we would at any rate enjoy freer trade.

14. It is unquestionable that we have lost sight of the importance of our home market. Should expectations not be realised that all foreign nations, both those who supply foodstuffs as well as those who do not, did not meet our changed policy by an adjustment of their own, some at any rate would be obliged to do so. It is anticipated we would recapture a large portion of our home trade in manufactures.

15. There is a measure of agreement amongst commercial people that this intricate question should be lifted out of the realm of party politics. I may say that I am approaching this subject with as much impartiality as is possible, but with the sincere idea that Protection of industry is one of the chief steps to be taken to save our country. Immediate action is necessary in order to save the situation; the undoubted adjustments which would have to be made could be reached later as the result of negotiations.

16. Some reference must be made to what is known as "Capital Development Schemes." During the whole of the last decade

Local Authorities have spent many millions in this way, in order as was hoped to deal with what was expected to be merely a temporary phase of unemployment. However, as the years have passed and the situation has become worse instead of better, the number of such possibilities of Capital Development has steadily decreased. Even after the deduction of much Government help, which the taxpayer has had to find (and which has kept up to a certain extent the high rate of taxation), the Local Authorities have been left with debts the liquidation of which will for some years prevent that reduction of local rates which is essential to help our manufacturers and producers to reduce their overhead costs. Moreover, it must not be overlooked that many of these schemes have not been carried out on an economic basis.

17. Judging by the limited experience of Safeguarding, new factories would undoubtedly be required, so that efforts in this method of Capital Development would be beneficial because, as soon as they were completed, they would become the means of the production of wealth.

18. Apart from such schemes just mentioned, there are two others of such magnitude that they would take years to complete; in the meantime large numbers of unemployed would find work. An additional benefit would be increased employment in the trades producing the necessary materials. Further, it is common knowledge that for every man in ordinary employment another man finds employment to produce the necessities of life for the first-named and his family. The two schemes are :—

(a) The electrification of the railways.

(b) Drainage of those parts of the country which are so frequently flooded.

19. With regard to the first, the Report of the Committee on the Electrification of Railways has just been published. It is safe to say that the change over from steam to electricity would take at least ten years, not only for monetary reasons, but also from the fact that unless it were carried out gradually the men displaced might easily outnumber, for a time at any rate, the number engaged in the new work essential for the change over to electricity.

There is no doubt, judging from the experience of other countries which have electrified their railways either wholly or partially, that the ultimate result of the change would give us a new lease of life in our transport system, besides being a great step in the direction of enabling us efficiently to compete again in the world's markets, provided that Tariff walls were not further raised against us.

20. In respect to (b) Drainage, there is little doubt that well devised schemes would avoid, probably for ever, the devastating effects of flooding which at certain seasons of the year the traveller

can see for himself from the railway train as he journeys to different parts of the country. I am informed it would improve the navigation of those rivers which are navigable. The cost of this work could in the first instance be paid for by public loans, the subsequent liquidation of which ought to be met by a small charge per acre which would amount to far less than the costs incurred at present by those concerned.

21. Both these schemes would have the result of equipping us better for the battle of life. In the case of the agriculturist it ought certainly to remove from his mind the constant fear of loss and even bankruptcy, through causes for which he is not personally responsible and over which he has no control. Certain Harbour Authorities should also derive great benefit. The main-spring of enterprise is profit. That an industrial or commercial enterprise should make profits is not injurious to the community, but under free competition rather a measure of its usefulness. The employee rightly desires his fair share of the fruits of his labour. It has been distressing to employers to have to insist on reductions of wages, but could they have acted otherwise under existing conditions?

22. I believe that, with the introduction of changes such as are advocated above, real wages will advance and the state of affairs produced will approximate to the conditions of pre-war days. Of course, we shall have Cycles of Trade, as in former days, but we will not see ourselves merely enjoying the overflow of booming conditions of Continental countries.

The British are a practical people. If they find that the expectations of the suggested changes in our Fiscal System are realised they will be grateful, but if I am wrong in my suggestions it will be recognised that an honest attempt has been made to rectify a very grave situation which has become so perilous to our welfare. Moreover, are our foreign competitors wrong in their policy?

23. I do not feel myself competent to express an opinion upon the recommendations regarding the Note Issue as set out in Part II, Chapter III.

24. I dissent from the "Proposals Relating to Information and Statistics" detailed in Part II, Chapter V. I consider that the trouble and expense is unnecessary, as the statistics when available will be out of date; besides there are now published such masses of statistical information, which should enable the practical person to form correct judgments on trade and commerce, whilst the ordinary theorist has adequate data at his disposal for the examination of all the abstract problems which he may desire to investigate.

WALTER RAINE.

MEMORANDUM OF DISSENT BY LORD BRADBURY.

1. I regret to find myself in disagreement with most of the conclusions formulated in this report. Leaving out of account for the moment the effects of the recent heavy fall of world prices, I think the main causes of the economic troubles of Great Britain since the War have been (i) the burden of unproductive debt, (ii) overlavish expenditure by the State and local authorities, (iii) excessive cost of transport and distribution and of the products of sheltered and protected industries, and (iv) the attempt by all classes to maintain a standard of living higher than is justified by the facts of the economic situation.

2. The burden of unproductive debt is partly that of the dead-weight debt arising out of the War. But this is by no means the whole story. The debenture debts of, and bank loans to, industries which cannot, or can only just, make ends meet, and the maintenance of railway rates at the level necessary to provide a return on capital which has to a large extent ceased to be economically productive—to take only two instances—are burdens of a very similar nature.

Out of the total produce of industry the creditor and the State—on behalf of the rentier and also to meet public expenditure on services other than the debt on a vastly enhanced scale—take a much larger proportion than before the War; transport and distribution also take a larger proportion (*teste* the wider gap between wholesale and retail prices). The remainder after providing for the remuneration of labour is in many industries not enough to leave a sufficient margin to induce the entrepreneur to continue his exertions or hazard fresh capital. The weakest close down and the maintenance of the workmen thrown out of employment increases the pressure on those still at work. The next weakest then succumb and the process seems likely to continue until the volume of production is so reduced as to be unable to support over the whole country even the standard of life at present enjoyed by the unemployed.

It is no doubt true that the payment of the interest on internal debt and allowances to unemployed workmen* are merely "a transfer of incomes within the country", but (except in so far as they are met by the taxation of rentier or the unemployed workman himself) it is a transfer from the producer to the non-producer. If it goes far enough it will leave the producer with no motive to produce and in the end cease perforce because there will be nothing to transfer.

* The burdens on productive industry arising from the charges for dead-weight debt and those arising from the cost of maintenance of the unemployed are very similar in character and effect, but the latter have the peculiarly devastating property of varying inversely with the production which has to support them.

That catastrophe has not occurred earlier is mainly the result of the tremendous strides in the technological efficiency of industry which have taken place concurrently, but to take full advantage of these considerable capital expenditure is necessary and when industry is unprofitable the necessary capital is not forthcoming.

3. If this is a true diagnosis it appears to me that the malady is too deep-seated to be removed by any manipulation of currency or credit.

True if it were possible to raise the price level the burden of debt would be decreased and, in the (what seems to me improbable) event of the workmen being content to accept the same money wages notwithstanding the increased money cost of living, the real cost of labour would be diminished. But any appreciable rise in the price level above the level of world prices without reducing the gold value of the pound or abandoning the gold standard altogether is impossible, and I agree with the majority of the Committee that recourse to either of these expedients would be most undesirable.

I am of opinion that the real remedies for our economic troubles lie in the main in a field outside the terms of reference of the present Committee.

4. In regard to the international working of the gold standard, I agree that efforts ought to be made to secure by international agreement a better distribution of existing gold stocks and greater economy in the use of the metal but the attempt made in the Report to formulate the objectives to be aimed at seems to me in conception too ambitious and for application too nebulous.

5. Under the head of International Monetary Policy of a Permanent Character (Part II, Ch. II) a word of caution is necessary particularly as regards the objective in the more distant future. I doubt whether the fixation, by co-ordinated action of the Central Banks, of the world value of gold at such a level as would secure a stable average level of wholesale world prices is feasible or even desirable. Such a proposal really means the substitution of an index figure for gold as the standard of value and (apart from the utility of gold as an ultimate reserve in the event of the new system breaking down—a contingency which it would be imprudent to ignore) the new unit of value would, if the proposal were adopted, be better represented by a counter to be issued by a trustworthy international authority. The world would then be saved the labour and expense of gold-mining and the Central Banks the worry of having perpetually to devise expedients to adjust the value of that no longer necessary commodity to the value of the new unit.

Whatever theoretical case can be made out for such an innovation—with or without the retention of gold as an accessory—I doubt whether the proposal will come within the range of practical international politics during the lifetime of the youngest of us.

Nor is stability of average prices necessarily desirable. Suppose that the present progress of scientific agriculture is not maintained and that, owing to the increase of the population of the world, food and raw materials tend to rise in price relatively to manufactured products even though manufacture does not become more efficient, is it ideally desirable to have stability of average prices, i.e. a fall in the prices of manufactured goods to compensate for the rise in the price of food and raw materials? Surely that would intensify the difficulties of adjusting costs to prices on which my colleagues have laid so much stress.

I would, therefore, in regard to the more remote future, confine myself to aiming by international co-operation at such economies in the use of gold as will correct the ill effects of the probable failure of gold production to keep pace with the growth of world requirements. The difficulties in the way of effective international agreement to secure such economies are so formidable that any theoretical danger of excessive economy resulting in world-inflation may safely be ignored.

6. When I come to the measures outlined for dealing with the present world crisis, I agree that a general increase of the world price level would materially alleviate the present economic depression, and incidentally obviate the painful adjustments which will otherwise be required to bring our domestic price level into relation with that of the outside world. It seems to me, however, that the treatment of this subject in the Report is at once too sweeping and too sketchy. I cannot associate myself with such statements as that in paragraph 271 that "a failure by the Central Banks of the world to attempt to redress the fall of prices would endanger the principles on which modern economic society is founded." Nor do I regard it as advisable for the Committee to treat what may in fact prove to be impracticable as an "immediate necessity." Further, if the remedy is to be administered, those who prescribe it should at least be prepared to specify the manner and extent of its application. But the Committee (paragraph 266) "do not consider that a high degree of precision in the definition of this (price level) is necessary or practicable." In paragraph 277 similarly, they admit that they cannot "give a confident answer to doubters" as to whether a restoration of the price level is in fact feasible. Again, on the cardinal question as to whether Central Banks are to attempt to counteract a fall in the price of one commodity by a general rise in other prices, the Committee (paragraph 300) "do not think it necessary to give a dogmatic answer to such questions." Moreover, the trouble is admittedly an international one which cannot be solved by this country alone, and it is well known that in certain other countries, particularly France, public opinion is not only unwilling to promote an increase in the price level but is determined to oppose it. The Central Banks in France and most of the continental countries have no

power to undertake open market operations which will be required if any such attempt were to be made. This being the case, even if theoretically there may be much to be said for the Committee's views, they seem to have little relation to the real facts of the actual world.

7. I am in agreement as to the necessity of co-ordinated effort on the part of the creditor countries to aid the debtor. But it must be remembered that, even before the crisis, many of the debtor countries were applying new loans not to the creation of productive assets, but to meeting international deficits on revenue account—a process which if continued leads inevitably to default. In such circumstances the drying up of the supply is sooner or later inevitable and it is difficult to see how the stream can be made to flow again until they have put their houses in order. Where there is evidence of the intention and ability to do this, the granting of loans to tide over the necessary interval should be arranged. In some cases, no doubt, guarantees will be necessary. In such cases I should prefer, whenever possible, that the guarantees should be those of groups of private institutions, both because this would secure that the propositions handled were limited to those involving only fair commercial risks, and also because mistakes when made would be wiped out by the painful but salutary process of ordinary liquidation instead of going to swell the already well-nigh intolerable burden of permanent deadweight debt.

8. The revival of enterprise in the creditor countries themselves will, as pointed out in the Report, in itself improve the situation of the debtors and this is equally true whether the revival takes the form of increased production of capital or of consumable goods.

The tendency of long-dated high-class securities to rise in value, which is invariably observable in times of commercial depression, will undoubtedly encourage certain classes of constructional enterprise, but I cannot accept as valid much of the argumentation on this topic contained in Chapter XI of Part I or the conclusion that it would be wise to create credit for which there is admittedly no demand with the hope of artificially inflating security values and so cheapening long-date credit for capital enterprise.

The Report itself admits that such surplus credit would become dangerous and would require to be retracted once a trade recovery were well under way. The retraction would inevitably depreciate the value of the securities into which its creation had lured the investor and an unpleasant impression would be created.

In an individualist society capital can only be provided by inducing individuals to forego present enjoyment in exchange for future advantage. It is no doubt a convenience to all except the individuals who have made the present sacrifice that, the capital having been provided, the future advantage should be diminished

or fail to materialize altogether. When the capital investment takes the form of securities representing money claims this will happen if the rate of interest is reduced by artificial supplies of cheap money and if the enjoyment value of the capital claim itself is diminished by raising the price level. Both these results can be brought about by expanding credit. Indeed, if the expansion is great enough, the future advantage reaped from the sacrifice may easily in terms of enjoyment be less than the sacrifice itself—the ultimate loss of real value in respect of the capital claim being greater than the interest received in the meantime.

This superficially clever device will, however, cease to be effective the moment its *modus operandi* is understood, since it makes fixed money claims dear at any price and destroys the motive for saving in order to invest in such claims.

So far as the result might be to encourage investment in equities instead of fixed money claims the change, within limits, might be salutary, but the plan is put forward for the purpose of stimulating capital development by means of loans, and this it can only achieve in so far as it may succeed in hoodwinking the real investor.

If currency "management" is to be used to facilitate manoeuvres of this type, the sooner we return to an "automatic" system the better. Honesty, even if stupid, is a better foundation for credit than the most adroit finesse.

9. Turning to the proposals contained in the Report for action in the domestic sphere, I find little which appears to me to be likely to be useful and much that will in my opinion be positively harmful.

The recommendations for fundamental alterations in the regulations governing the note issue and for the amalgamation of the Issue and Banking Departments of the Bank of England fall into the latter category.

To allow expansions of the volume of legal tender money to be made otherwise than in exchange for gold appears to me to be a dangerous innovation which is likely to jeopardize the maintenance of the gold standard.

It must be remembered that the times at which an increase in the legal tender circulation is required are times of trade activity and rising prices—conditions which invariably go together. At such times money* tends to be plentiful and inflation is apt to develop unless the expansion is kept in check.

An outflow of notes into circulation under the existing system tends to contract the basis of credit by reducing the cash reserves

* I say "money" rather than "credit" because a large part of the increase of purchasing power arises from the coming into employment of balances previously idle without any increase in the total of bank deposits.

of the banks. If the exchanges are favourable the deficiency is made good by the import of gold. If they are unfavourable, credit expansion is checked until they become so, with the result that the price level is prevented from rising to the point at which it will cause an actual gold outflow and require an even greater degree of restriction to stem it.

10. The gold reserve for the currency should, in my view, never fall below an amount equal to the maximum foreseeable contraction of the circulation at any given moment, *plus* whatever may be regarded as the irreducible minimum figure required to maintain public confidence and provide a reserve for great national emergencies.

If gold is accumulated when trade is on the upgrade a reserve is created to meet exchange requirements should these arise when trade is static or on the downgrade and *pro tanto* the evils of high money rates and restriction of credit are avoided at moments when these are particularly harmful.

Indeed to insist on gold import as a condition of currency expansion tends to slow down the processes of raising and lowering internal prices to adjust them to variations of world prices and so contributes towards that stability of the internal price level which the Committee recognize as a desideratum.

11. But quite apart from these considerations of practical expediency, in regard to which the balance of advantage is in my view heavily in favour of the existing regime, there are fundamental differences of principle between the two systems. The system of the Bank Act of 1844, which is continued in its essentials under existing legislation*, is based on the principle of safeguarding the gold value of legal tender money by providing that expansion and contraction in volume can only take place in exchange for gold, and of leaving the volume of banking credit, whether created by the Bank of England on the basis of the legal tender money in the Banking Department, or by the joint stock banks on the basis of legal tender in their own hands or Bank of England credit, or again by other institutions on the basis of joint stock bank credit, free to expand or contract according to the ease or difficulty of obtaining legal tender money.

So far from this being a rigid system it is, with a free gold market, a perfectly elastic system, subject only to the qualification that expansion can only take place when the foreign exchanges are favourable and contraction is enforced when they are unfavourable.

* The provisions of Section 8 of the Act of 1928 do not in themselves mean more than giving statutory recognition to the practice previously followed without legal authority in emergencies and providing machinery for varying the amount of the fiduciary issue in the event of permanent changes taking place in the total currency requirements of the country.

12. The system proposed by the Committee if carried to its logical conclusion,* ignores the volume of legal tender altogether and seeks to maintain the gold value of the pound by direct action by the Bank of England on the volume and price of bank credit. It does not, however, provide any real criterion of the occasion for such action, or of how far it should be carried when embarked upon, but leaves the settlement of these questions to the uncontrolled judgment of the Bank of England upon economic and financial tendencies which are admittedly most difficult to interpret.

Under the old system we have a currency system administered it is true by the Issue Department of the Bank of England but in regard to which the Bank has no discretionary power, and a credit system under which both the Bank of England and the joint stock banks are free to create such amount of credit as banking prudence permits on the basis of the available supply of currency. They have a commercial inducement for expanding credit to the maximum amount compatible with the safeguarding of their banking reserves and are in a position to reply to criticism (which so long as human nature remains unaltered will always be readily forthcoming) that they expand too slowly or contract without necessity that at any rate they are sacrificing profit to safety.

Under the new system the Bank of England is to have free discretion (subject only to certain extreme limits which would not in practice be enforceable) to take, according to its judgment of what is in the general interest, without risk or cost to itself—indeed the plan goes out of its way to safeguard the bank from loss arising out of its discretionary action—steps which will acutely affect the lives and fortunes of the lieges. The facts on which it has to form its judgment are so difficult to interpret that legitimate differences of opinion as to the wisdom of the steps taken are likely to arise on almost every occasion.

This surely is to place a private corporation in an impossible position and must lead before long, in a democratic community, to complete government control of the Bank of England to be followed in due course, since the plan will not work without giving wide discretionary powers to the joint stock banks also, by government control of these banks. I am in agreement with the majority of the Committee that such control is undesirable.

Further the Bank of England and the joint stock banks are not the sole credit-creating organs. A comprehensive plan

* Under the proposals as they stand the maximum limit of the fiduciary issue and the minimum limit for the gold reserve would indeed operate to require an attempt to be made to revert to something like the old system in the event of an acute crisis, i.e., in the face of the very conditions which necessitate a temporary suspension of the old system even when it has been in operation. I regard it as certain that the suggested maximum and minimum could not in practice be enforced.

for the direct control of credit would have to have regard to those institutions (which are increasing in numbers and importance) which build credit structures on the basis of deposits in joint stock banks not unlike those built by the joint stock banks themselves on the basis of their cash in hand and at the Bank of England.

13. It is no doubt true that a loss of gold sometimes—in the exceptional circumstances of recent years it would perhaps be true to say often—arises from causes other than a real tendency of the pound to depreciate, and similarly a gain of gold from causes other than the opposite tendency. I agree that fluctuations of foreign balances, particularly when the result of political rather than economic causes or of exceptional economic disturbances in particular foreign countries, are apt to disturb the normal working of the gold standard. I agree also that special reserves in this connection are most desirable. Such reserves might properly take the form of the maintenance by the Bank of England of liquid resources at various centres in foreign countries or of balances with the Bank for International Settlements (if that institution proves suitable for the purpose). By this means an additional demand on the world's gold stock would be avoided.

The same expedient might usefully be resorted to in regard to further additions to the currency reserve proper if and when a figure is reached which it is undesirable to exceed for considerations of general economy of gold.

14. On the question of the desirability of "strengthening" the Bank of England I have no real data for expressing an opinion. Whether its reserves (published and unpublished) are sufficient for the efficient performance of all its duties is a matter on which the Bank alone is in a position to judge, and the Bank has not only not asked for an increase but not even remotely hinted that an increase would be welcomed.

I see no objection to the Bank of England being allowed to increase its capital if it thinks it necessary or desirable either in its own interest or the public interest to do so.

On the other hand I see no reason for asking the joint stock banks to increase either their legal tender reserves or their balances with the Bank of England above the amounts required to provide for their actual requirements and their own security. *Per contra* I would not relieve them of the necessity of maintaining the reserves necessary to protect themselves against the depletion of their stocks of legal tender by expansion of the demand for internal circulation.

The right to issue legal tender money being a prerogative of the Crown, it is right and proper that the profits of the Issue Department should accrue to the Exchequer. This is secured by the present arrangements, which I see no sufficient reason to alter.

The Bank of England is placed in exactly the same position financially as it would be if there were no note issue and all money of unlimited legal tender were gold. I hold that the Bank of England, like any other banker, should in regard to its banking activities so arrange matters as to be able to afford to keep in the Banking Department whatever reserves of legal tender money are necessary for safely carrying on its business. After all, the object of increasing the fiduciary issue, if an increase is made, is a simple one—to provide the Banking Department with more legal tender money either to use or to hold in reserve. In so far as the additional money is used, it will be income-producing, in so far as it is held in reserve, it is either necessary or unnecessary. If it is a necessary addition to the reserve, the cost of keeping is an incidental expense of the banking business: if it is unnecessary, why create it at all?

It is no doubt true—as indicated in paragraphs 334 and 335 of the Report—that if the Banking Department runs short of ready money it may have to part with income-producing assets. But that is quite a common experience in the world at large and it is not usually considered to be a ground for compensation.

It is also true, as pointed out in paragraph 337, that the cost of “sterilizing” gold imports which could not be allowed to have their normal effect of expanding the basis of credit might seriously embarrass the Bank. But this has nothing to do with the profits of the note issue, and in fact, in the interests neither of world economy of gold stocks generally nor of the proper working of our own currency system ought such surplus stocks to exist except accidentally and then for very limited periods. If surplus gold is the result of an excessive influx of foreign balances, its accumulation should be checked in the manner indicated below: if it is the result of an unduly low domestic price level, it should be allowed to form the basis of credit until the disequilibrium is corrected.

Under the gold standard, gold in quantities which can be digested is a food, in excess it becomes a poison. The system ought to be worked in such a way as to leave to other nations what they require for food, not to take it and then have to lock it up so as not to be poisoned by it.

15. As regards the proposed amalgamation of the Issue and Banking Departments of the Bank of England, this would no doubt be a natural—perhaps a necessary—consequence of the adoption of the other proposals in regard to the Note Issue.

If the present note-issue system is maintained, I would also retain the independence of the two Departments. Apart from the objection that the amalgamation removes familiar land-marks and involves a more or less prolonged period of uncertainty in the minds of those who are concerned in monetary business before experience has taught them what practical conclusions to draw from the new figures, the separation is in fact the embodiment of

the principle which has dominated the British monetary system for nearly a century that, with a strict control of currency, a large degree of freedom can safely be given to credit. The Issue Department is bound by precise rules. In the Banking Department the Bank of England has free discretion.

While it is no doubt true that since the restoration of the gold standard it has not been possible for the Bank of England to be guided in its credit policy wholly or even mainly by the level of the reserve in the Banking Department, the traditional recognition that that reserve has to be protected has undoubtedly strengthened the hands of the Bank in taking measures which though necessary are bound to be disagreeable.

16. I am not satisfied that all the difficulties which have caused the Bank to depart from traditional practice in the direction of elaborate "management" are permanent or irremovable.

A large part of them were the consequence of currency derangement at home and abroad resulting from the war and subsequent stabilisation.

Other disturbing influences in my view have been the enormous accumulation of liquid credit arising mainly from too narrow a margin between short and long money rates and the excessive volume of Treasury bills, and possibly the attempt (due to what I believe is a misreading of the report of the Cunliffe Committee) to maintain the gold reserve in the neighbourhood of £150,000,000 instead of allowing it to find its own equilibrium point.*

* Under the existing currency system, either as it existed before the War or in the form in which it was re-established by the Act of 1928, the total volume of legal tender adjusts itself to the requirements of the country at a level of prices determined by the balance of payments operating on the exchanges. The amount of gold which can be retained is therefore equal to the total legal tender required for circulation and bank reserves less the fiduciary issue. If, as I believe to have been the case, the total of legal tender required has since the fiduciary issue was fixed at £260,000,000 been less than £410,000,000, it follows that an attempt to retain £150,000,000 of gold is trying to put a quart—or at any rate more than a pint—of water into a pint pot.

The proposal of the Cunliffe Committee was gradually to reduce the fiduciary issue until a figure was reached which experience should prove was consistent with the retention of £150,000,000 of gold under normal conditions and then to fix the fiduciary issue at the amount to which it had actually been reduced. It became desirable, however, to make the transfer of the note issue to the Bank of England before the experiment initiated on the recommendation of the Cunliffe Committee had been continued long enough and before conditions had become sufficiently normal to arrive at a reliable judgment, and the fiduciary issue was fixed on the best evidence available at £260,000,000. If, once the £260,000,000 fiduciary issue had been fixed, the gold reserve had been left to find its own equilibrium point and this had proved to be less than £150,000,000, we could either have contented ourselves with the smaller figure or, if we still attached importance to the £150,000,000, have reduced the fiduciary issue (choosing a moment when gold was flowing in) by the necessary amount.

17. It is in my opinion highly probable that the embarrassing accumulation of what are euphemistically termed liquid funds, but which I should prefer to call surplus credit, which has been a characteristic feature of recent years has been to a large measure due to the attempt to retain a larger stock of gold than is required for the working of the currency system on the lines of the actual fiduciary issue from time to time—since 1928, £260,000,000.

An outflow of gold arises from one or more of the following three causes, an unduly high internal price level, an excess of foreign lending or a withdrawal of foreign balances. It may be stemmed by a return of foreign balances, a withdrawal of money lent abroad* (or sale of securities having an international market) or an alteration in the relative volume of exports and imports by a fall in internal prices. A rise in bank rate will tend to bring the first two corrective forces into operation more quickly than the last, but if the outflow of gold has caused a reduction of the basis of credit the return of foreign balances and withdrawal of money lent abroad will not increase it again unless and until they actually cause gold to flow in. If such an inflow begins before the price level has been adjusted the maintenance of a high bank rate can do nothing but mischief. The rate should be lowered to the point necessary to check the inflow and leave the reduction in the basis of credit to have its effect on the price level.

But if an attempt is made to maintain the actual stock of gold above the figure which represents saturation point on the basis of the actual amount of the fiduciary issue, it means that equilibrium of the exchanges will be produced by the attraction of foreign balances by means of a high bank rate with a volume of credit and currency too large to bring about the necessary adjustment of price level. If it be desired to retain the surplus gold, these balances must either be retained by the continuance of a high bank rate, or brought back by another rise, if a lowering of the bank rate has caused their withdrawal and a consequent renewal of the gold drain.

Thus the high bank rate becomes chronic and so far from doing any good merely makes matters worse, since by depressing industry it diminishes production and by releasing credit from industry increases the amount of short money, whereas, if the gold had been allowed to go and the basis of credit had been restricted in the first instance, remedial forces would have been put into operation with which no subsequent movement of balances could have interfered.

Indeed we owe the creditor position which we occupy in the world more than to anything else to our willingness in the old days to part with gold freely whenever the exchanges required it and

* i.e. British liquid funds in foreign centres or foreign bills held in London (which a bank rate higher than that of foreign centres drives to the centres having a lower rate). Long-date loans cannot, of course, be withdrawn.

to defer raising the bank rate until the depletion of the reserve in the Banking Department of the Bank of England made it necessary to do so. This kept our internal prices almost continuously down to the level necessary to secure a favourable balance on the international exchange of goods and services, which was largely absorbed by foreign investment before it could lead to an excessive gold influx.

18. The fact that this creditor position exists is not without danger, since it is obvious that it makes it possible for us to dispense with the favourable balance on goods and services so long as the deficiency can be made up by an excess of interest on existing foreign investments over new foreign investment and indeed longer if we are prepared not to increase or even to diminish the corpus of our foreign investments themselves.

But a diminution of new foreign investment will probably contract the volume of our exports and so reduce our visible exports, while the weakening of our creditor position will reduce our remuneration for international services which is a very important part of our invisible exports. Any temporary relief therefore that we might secure in this way would be at the cost of a progressive future decline.

19. But, quite apart from the undue accumulation of short money which results from attempting to deal by means of bank rate alone with a situation for which the proper remedy is an efflux of gold, the volume of such money generally since the War has been of such magnitude as to render the task of the Bank of England in controlling the supply (as distinct from the price) of the basis of credit extremely difficult. The main cause of this has been the enormous amount of Treasury bills. This has resulted not only in increasing the dimensions of the bill market (and so making larger scale operations necessary to produce a given effect) but also in altering its character. When the holdings of the market were mainly commercial bills drawn on London on foreign account, a rise in bank rate diminished the supply of these bills. Now that the market holdings are largely Treasury bills and other Government "floaters," a restriction in the volume of bankers' cash, followed by a reduction of their market money, merely drives the "market" "into the Bank," i.e., forces the Bank of England to recreate the credit it has previously withdrawn—the discomfort traditionally associated with that lodging being largely mitigated by the fact that the general taxpayer bears a large part—sometimes more than the whole—of the expense in the form of a higher discount rate when the bills fall due for renewal.

20. Apart from the difficulty which it creates in the control of the volume of credit by the Bank of England, the excessive volume of Treasury bills has harmful effects of a more general character. When credit has to be restricted the renewal of the bills comes

into direct competition with the demands of industry, tending to force up the rates which industry has to pay for accommodation. Further it encourages both directly and indirectly the accumulation of liquid funds by industrial concerns. Treasury bills not only provide a convenient and profitable vehicle for the employment of such funds, but they enable the banks to hold large fixed deposits at comparatively high rates of interest without risk to themselves.

The result has been that large and wealthy concerns to a much greater extent than formerly carry on their business by means of accumulated funds instead of with borrowed money. The consequence of this is that the pressure of credit restriction, when it becomes necessary, is rendered very unequal in its incidence. These large concerns are in no way hampered by a rise in short money rates—indeed they actually profit by it—and the whole burden is thrown on the weaker concerns which trade with borrowed money. In so far as the latter may be compelled to curtail their activities, the former can expand to fill the gap without cost to their profit and loss account for interest charges, since the loss of interest on the liquid funds so employed will be offset by the higher rate on the remainder.

21. It thus follows that the first result of an attempt to restrict credit is merely to transfer business from the weaker to the stronger concerns, and before an impression can be made on the total volume of active purchasing power the pressure on the weaker concerns may become so acute as to drive them out of business altogether. We might reach a state of affairs in which the whole of the trade and industry of the country would be carried on on the basis of credit balances against which the banks would hold cash, Treasury bills and securities only. High money rates would then be powerless to check expansion unless and until a point was reached at which it would be more profitable to the industrial concerns to keep their balances on deposit than to employ them in industry, or prices had risen so high that they not only had to employ the whole of them but borrow as well.

The former situation would be an impossible one for the banks except in so far as the deposits to be immobilized did not exceed their own short-date assets—otherwise they would lose money heavily, while the latter would not arise until inflation had gone far enough to disorganise the whole financial structure.

The truth is that any considerable volume of idle deposits representing dormant purchasing power which can at any moment become active purchasing power, not merely without the help but even in the teeth of the opposition of the banking system, is a menace to the system itself. So long as the volume of such deposits is small in proportion to bank advances, the banks can, by bringing pressure to bear on debtors, counteract the increased activity of

creditors, but a point may be reached at which this is no longer possible and then the whole machine breaks down.

22. It is very desirable—it may even in the not remote future become vitally necessary—that idle deposits in the joint stock banks should be reduced to a minimum and that the total deposits of these banks should be confined, as far as possible, to the necessary circulating medium of trade and industry.

The best methods of bringing this about are :—

(1) Reduction in the volume of Treasury bills, thus diminishing the field for the profitable employment of liquid resources generally.

(2) Working the gold standard in such a way that when a rise in the bank rate becomes necessary the period of the high rate shall be of brief duration, and for the rest keeping short money rates as low as possible (see above).

(3) Avoiding any action which will tend artificially to inflate the prices of long-date securities and so diminish their relative attractiveness as an investment for reserves.

23. I am aware that Treasury bills are a source of considerable profit both to the banks and the market and play so large a part in their daily life that they can scarcely picture—at any rate are unable to contemplate with equanimity—a world without them. But the Sabbath was made for man not man for the Sabbath, and if it is desirable, as I believe it is, in the interests of the financial system as a whole, that the amount should be drastically curtailed, the banks and the market must adapt themselves.

Inland trade bills (the revival of which would be very healthy for trade and industry themselves) might with advantage fill up a part of the gap.

24. It would be well also that the volume of inactive deposits in the joint stock banks should be reduced by the sale by the banks of long-date securities to their customers. The improvement of their cash proportion would enable them when occasion arises to increase their active deposits by purchase of inland bills and by advances to trade and industry. When there was a large number of banks whose advances were largely confined to particular localities and particular trades, a reserve of high-class readily marketable securities as a second line of defence was essential and an "over-lent" position was rightly regarded as evidence of weakness. This is still the case in regard to the surviving smaller banks and might be the case in regard to the big banks if they pursued sufficiently different policies to cause large cash transfers from one to another, but so long as they "keep in step" and confine their advances to proper banking propositions (covering any which become "frozen" by creating reserves) there is now no real necessity for maintaining a large volume of investments.

25. It is a mistake to suppose that, during the period from the restoration of the gold standard until the beginning of the world slump, trade and industry in Great Britain were uniformly or even generally unprofitable. The Income Tax returns, indeed, are conclusive evidence to the contrary. Generally speaking, apart from the export industries and industries (including agriculture) directly exposed to foreign competition in the home market profits were above the normal, and this notwithstanding the burden of taxation, unemployment and high money rates. This to my mind proves that the trouble was due not to a shortage but to an excess of currency and credit which had the effect of raising prices wherever prices could be raised and raising costs generally, including those in the export industries and industries in which prices could not rise because of foreign competition. The effect of "safeguarding" in certain of the latter industries was to extend to them the advantages of the naturally "sheltered" industries and increase the pressure on the remainder. In these conditions—I am dealing with the period prior to the world slump—a diminution of internal purchasing power resulting in a fall in the domestic price level would have been far from being the unmixed evil which some of my colleagues appear to imagine. A comparatively small fall in prices would have encouraged the export trades and diminished the pressure of foreign competition in the home market on those industries which are exposed to it. Even assuming the rigidity of money wages, which is by no means absolute, some costs would have fallen and more certain markets and increased output at the lower price level might have compensated largely for the lower prices themselves. To the sheltered and protected industries on the other hand and to the distributing trades, reduced purchasing power in the hands of the public would have meant diminished sales, with the result that they would have cut prices (as they could well afford to do) in the hope of recovering their turnover. The result would have been a much healthier distribution of profits as between sheltered and unsheltered trades, and a diminution in the cost of living greater than the fall in prices in the unsheltered trades. This would have paved the way to a reduction of money wages without diminution—possibly even with increase—of real wages in these trades and in the transport services. The latter, if it could have been effected, would have reduced the cost of living still further and given further help to the export trades.

26. It is possible that these desirable changes may still come about without deliberate restriction of credit if recovery from the world slump proceeds more slowly in this country than abroad—a not improbable event, regard being had to the fact that our disequilibrium before the slump began was more pronounced than that of most foreign countries. A rise in world prices with domestic prices remaining stationary, or following only slowly,

would have the same effect as a fall in domestic prices not reflected in world prices and would avoid a large part of the friction inseparable from the latter process.

But this hope will be disappointed if the price level is prematurely raised by well-meant but ill-advised measures directed to accelerating trade recovery.

27. In the case of a country situated as we are, a recovery to be durable must begin with the export trade. This will give a firm foundation for expansion of the home trade. Attempts to revive the home trade while the export trade remains unprofitable will, if successful, merely re-establish the old disequilibrium.

28. Another cause of trouble has been the excess of long-term foreign investment over what was available from the balance of international payments. This became possible without loss of gold by reason of the inflow of foreign short money but it made necessary the stereotyping of high money rates to retain that short money. The effect of continuously high rates for short money was to increase the attractiveness of short as compared with long-date investment at home. This should have been counteracted by a fall in the price and improvement in the yield of long-date securities but the excessive amount of unemployed bank deposits, and probably to some extent the necessary preoccupation of the Treasury and the Bank of England to secure the most favourable terms for funding maturing obligations and to pave the way for a conversion of the 5 per cent. War Loan, inhibited this tendency, thus increasing the relative attractiveness of the high rates offered by foreign long-term borrowers.

Governments can, and do, do much—sometimes salutarily but more usually with mischievous consequences—to interfere with the free play of economic forces but no Government has yet succeeded, though many have tried, to prevent capital finding its way to a more attractive market. Measures designed for that purpose are as effective as the fabled enterprise of building a wall round a swallow in order to enjoy the blessings of perpetual spring.

In the old days the British investor was content with a much lower return on home than on foreign investments by reason of his conviction that the former gave him better security. This was an enormous advantage to British industry. More lately the preference has been less marked. Recent and prospective events rather tend to show that after all Great Britain may not compare unfavourably with the rest of the world for political and economic stability and the old preference may revive. But be that as it may, excessive foreign investment and consequent trouble with the exchanges can only be checked by a fall in price of home securities to whatever may be in fact the competitive level.

29. It is in my view of great importance that the present opportunity created by the prevailing distrust of foreign investment,

cheap money and absence of industrial competition which have restored the market in home gilt-edged securities to favour should be taken advantage of first to fund a considerable proportion of the Treasury bills (other than those held by the Bank of England and public departments) and other Government debt of early maturity and to effect, if possible, a conversion of the 5 per cent. War Loan, and that thereafter home securities should be left to find their natural level.

30. It will be seen, therefore, that so far as domestic action in relation to currency and credit is concerned I pin my faith to the removal of obstacles which have arisen to the proper functioning of the existing system and have no confidence that benefit would result from a radical change in the system itself.

The steps which I have suggested for removing such obstacles would, I believe, restore to our financial system the ability to discharge its proper function—that of honest broker between those who have real values to exchange at home or abroad. To expect more of it is to fall into the ancient fallacy of mistaking money for wealth.

The existing system thus restored to efficient working would resume its old role of an efficient policeman to prevent our buying from abroad more than we can afford.

The proposed system gives no such safeguard and requires the creation of elaborate machinery for securing the maintenance of a proper balance of international payments.

As to the nature of that machinery the Report is silent, but I understand that various members will have divers and possibly conflicting panaceas to present in addenda. Until light shines upon this chaos it seems imprudent to proceed further with the creation of the new world.

31. The Report contains proposals relating to International Monetary Policy of a Permanent Character, proposals relating to International Monetary Policy to meet the present emergency and proposals relating to Domestic Monetary Policy of a Permanent Character, but there are no proposals relating to Domestic Monetary Policy to meet the present emergency.

Here again alternative suggestions will, I believe, appear in addenda.

Expedients which have been much canvassed—not necessarily as alternatives—are intensive capital development and attempts to stimulate agriculture and the industries whose products are subject to foreign competition in the home market by import duties.

32. The latter seems to me to be merely enlarging the list of sheltered trades at the expense of the export trades while, if these are compensated by bounties, we may find ourselves subsidizing the

foreigner* to buy British goods at the expense of the British consumer of foreign imports—a net loss to the national economy as a whole.

33. As regards intensive capital development any suggestion that this should be stimulated by credit inflation regardless of the real savings available to finance it† is wholly mischievous. Such expedients if successful are likely to create a situation which can only be dealt with by wide-spread liquidation, followed by still more acute depression. Further, it is doubtful whether the inflation of bankers' cash would have any early result other than to stimulate the purchase of securities by the banks from their customers, thus increasing their idle deposits with the danger of creating an unmanageable credit situation when a real revival begins.

In this connection it must be realised that only current savings are available for capital expenditure. Past savings in the form of idle bank deposits can, it is true, be so employed by their owners, but, if and when they are so used, the use of them, unless credit in general is restricted *pro tanto*, will have the same effect on the price level as the creation of an equal amount of new credit.

The same considerations apply to works undertaken by the State or Municipalities out of the proceeds of state or municipal loans and to works financed under state guarantee, unless real savings are available, with the further objection, even when this condition is satisfied, that unless the works are sufficiently income-producing to cover the loan charges their effect is to increase the burden of dead-weight debt which is already crushing industry.

If there were substantial reason to hope that works of this character would permanently reduce unemployment and so save an appreciable proportion of the present expenditure on relief, it would be worth incurring this latter risk, but I am not satisfied that real savings sufficient for any considerable effort on these lines are in fact available. Savings are hard to make in hard times. Unless they are available, it is not feasible to start a lasting trade revival by intensive capital expenditure at home. The essence of such expenditure is that it does not create an immediately saleable product. The expenditure itself, however, is in

* This would not be the case if the effect of the tariff was to raise the general domestic price level by a percentage equal to that of the duties and bounties, but in that event the duties would cease to be protective and the bounties to be helpful. The only advantage of such a plan would be that it would *pro tanto* reduce the real burden of debt upon production. Apart from many other objections to it, it is questionable whether it would afford relief on a scale sufficient to compensate for the friction and loss which its operation would entail.

† I have not space for a critical examination of the doctrine of the new school of economists that the profits resulting from capital expenditure will themselves provide the savings to finance it. The cynical maxim "let us eat and drink for to-morrow we die" has at least the common-sense to recognise by implication that difficulties may arise from the policy if death fails to ensue.

the main, through wages, upon articles of consumption, and, through materials, upon other immediately saleable products some of which are available for export. It will stimulate production at a rising level of prices of the articles of consumption and materials, it will also encourage imports and diminish exports in the industries immediately affected and increase costs in other industries. It will, in fact, have an inflationary effect comparable with that resulting from the issue of forced currency.

34. Part II, Chapter IV.—I concur in the recommendations contained in this chapter in regard to the Capital Market for Home Investment.

35. To sum up, I am of opinion that the causes which have impeded the development of trade and industry and led to increasing unemployment during recent years are in the main outside the domain of banking, finance and credit and that any reform within the scope of the terms of reference of the Committee can, at best, merely touch the fringe of the real problems.

36. As regards the matters falling within the terms of reference my conclusions are as follows :—

(1) It is to the best interest of this country to continue to adhere to the international gold standard at the existing parity, but efforts should be made to secure by international agreement a better working of that standard.

(2) Our existing domestic currency system should be maintained, reform being directed to removing the obstacles which have interfered with its efficient working and not to fundamental alterations in the system itself.

(3) The banking system discharges adequately and efficiently its proper function of providing short-date credit. It is not advisable that its functions should be extended, but a closer touch with industry in certain respects would be advantageous.

(4) Better machinery than at present exists should be devised for providing domestic industry, through institutions other than the ordinary banks, with long-date credit and permanent capital.

(5) The best contribution which the State can make to assist industry and promote employment is strict economy in public expenditure and lightening the burden of debt by prudent financial administration. Attempts to give positive assistance by diverting international trade from its natural channels, the State-financing of enterprises other than the ordinary public services, or the artificial cheapening by State guarantees of the supply of capital to particular undertakings are more likely to retard than to accelerate the restoration of a healthy and progressive national economy.

BRADBURY.

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APPENDIX I.

NOTES.

Table 1 gives an analysis of the main items of the monthly returns of the London Clearing Banks, commencing with January, 1919, in a form which differs from the published monthly returns principally in the following respects:—

(a) Cash in hand and Balance at the Bank of England are shown separately. (The cash items in the table do not include Balances with, and cheques in course of collection on, other banks in the United Kingdom.)

(b) Money at call and short notice is shown under the heads of (i) Money at Call, (ii) Money at short notice to the Money Market, and (iii) Money at short notice to the Stock Exchange.

(c) Treasury Bills discounted and Commercial Bills discounted are shown separately.

(d) Deposits are divided under the heads of (i) Current Accounts and (ii) Deposit Accounts. There is no universally recognised line of division between the two, but as far as possible current accounts are taken as sums payable on demand and deposit accounts as sums payable after date or notice.

(e) The head of Acceptances Outstanding does not include engagements for forward foreign exchange and other items frequently grouped under this head.

The statistics are the aggregates of the ten London Clearing Banks, but in the case of the National Bank figures relating to offices in England only have been included. For some items in the table in the early years estimated figures have been taken.

Table 2 gives the monthly figures of six Scottish banks on the same basis as is adopted in Table 1. The six banks are:—Bank of Scotland; British Linen Bank; Clydesdale Bank Limited; National Bank of Scotland Limited; Royal Bank of Scotland and Union Bank of Scotland Limited. In the case of one bank money at notice to the Stock Exchange is not distinguished; in another case money at call is included with money at short notice; and in another case the balance at the Bank of England is included in cash in hand and no money at short notice is given.

Tables 9 and 10. The figures of the London Clearing Banks comprise foreign deposits, etc., held by the principal London offices and offices in Liverpool, Manchester and Bradford. The figures of the Scottish Banks cover foreign deposits, &c. in London and, in some cases, at a principal office in Scotland. Deposits, Sterling Bills and Acceptances are each classified under the heads of—

(a) Banks with Head Offices abroad (including the Dominions).

(b) Foreign (including Dominion) Governments.

(c) Other foreign customers, including companies with head offices abroad.

It should be noted that under this classification, deposits, etc., held for, e.g., the Commonwealth Bank of Australia are included, while deposits, etc., held for, e.g., the Chartered Bank of India, Australia and China, and the Bank of Australasia, whose head offices are in London, are excluded. The figures do not in every case relate to the dates indicated in the tables but they are in all cases within a few days of those dates.

Table 11. This table combines the aggregate figures shown in Tables 9 and 10 with the aggregate figures of 30 Accepting Houses and Banks, compiled on the same basis. A further addition is the aggregate amount advanced to the Discount Market by Banks with head offices abroad and other foreign customers.

As indicated in the Report, the Table does not cover sterling bills held in their own portfolios by foreign institutions and agencies whether located in London or abroad. Nor does it cover acceptances by the Exchange Banks (with one or two exceptions).

TABLE 1.—ANALYSIS OF THE MONTHLY RETURNS OF THE LONDON CLEARING BANKS.
(£000 throughout.)

Date.	Cash in Hand.	Balance at Bank of England.	Money as Cml.	Money at Short Notice.		Treasury Bills Dis-counted.	Com-mercial Bills Dis-counted.	Invest-ments.	Advances (to, Loan and Over-drafts).	Current Accounts.	Deposit Accounts.	Total Deposits.	Accept-ances out-standing.
				To the Money Market.	To the Stock Exchange.								
1919.													
January	107,848	90,284	20,610	105,895	14,653	225,159	91,786	322,373	475,828	968,631	442,822	1,426,652	43,989
February	104,300	81,167	24,605	102,830	14,478	197,941	90,258	359,166	482,613	980,776	452,098	1,382,874	48,992
March	106,400	92,205	23,762	103,723	14,076	183,695	93,178	327,564	505,873	951,639	457,038	1,408,675	47,323
April	113,069	86,146	26,800	112,627	14,622	197,076	91,270	329,862	508,436	962,437	472,136	1,434,575	45,155
May	110,546	88,923	24,730	112,068	15,512	213,195	92,173	329,987	510,751	970,640	489,720	1,454,360	43,783
June	117,160	246,041	23,625	132,744	15,200	132,403	89,642	328,848	637,387	1,113,248	513,815	1,627,063	52,650
July	113,141	117,323	22,377	90,419	17,492	110,931	100,821	372,302	593,238	1,011,842	492,864	1,504,808	62,007
August	112,131	81,647	23,125	85,728	17,117	137,036	105,621	375,884	614,983	1,068,039	500,003	1,609,042	67,327
September	111,863	81,720	39,457	83,739	17,416	135,662	107,591	377,595	632,020	1,082,210	538,622	1,635,832	68,910
October	114,964	76,074	22,215	54,700	24,834	149,264	141,142	372,280	659,381	1,040,471	529,590	1,569,061	65,247
November	113,889	74,668	16,054	63,264	25,351	137,843	145,687	375,500	692,749	1,063,108	538,349	1,596,457	83,639
December	124,654	131,016	21,663	52,979	22,732	90,900	133,359	380,143	730,957	1,121,580	585,236	1,706,816	108,442
Monthly Average	112,423	103,861	22,919	90,868	17,698	159,235	106,848	361,417	579,638	1,016,910	494,933	1,510,743	61,459
Monthly Average (excluding June and December)	110,733	86,915	22,974	90,469	17,444	168,751	105,927	350,801	569,708	985,809	486,994	1,482,608	57,652
1920.													
January	113,636	88,682	21,040	56,779	22,809	104,512	162,147	380,799	777,680	1,134,732	578,302	1,708,034	107,276
February	104,983	4,078	22,013	52,556	25,256	77,186	138,054	574,612	516,701	1,114,267	568,532	1,683,859	110,657
March	86,832	69,754	53,543	57,359	27,032	73,849	138,198	370,686	861,719	1,118,925	574,017	1,698,942	99,033
April	88,415	82,715	53,348	49,050	23,969	78,194	148,481	365,283	801,661	1,118,685	568,711	1,707,296	87,468
May	100,946	90,588	53,934	48,435	24,426	78,436	132,455	370,082	860,622	1,078,201	597,180	1,672,381	72,045
June	106,272	93,593	53,924	52,329	24,771	83,520	121,278	371,039	844,458	1,103,496	615,382	1,715,585	64,205
July	107,731	78,316	52,970	55,970	20,972	75,575	143,578	385,259	869,431	1,079,492	689,756	1,716,187	59,864
August	108,777	76,878	24,743	59,811	21,696	83,473	148,578	393,495	894,714	1,079,992	684,714	1,720,308	66,867
September	110,561	87,977	26,581	54,081	20,114	146,740	152,638	390,377	892,572	1,063,448	646,269	1,720,040	64,242
October	110,955	68,544	25,951	60,916	18,803	177,435	103,539	390,377	892,572	1,063,448	646,269	1,720,040	60,067
November	107,636	132,324	25,681	60,989	17,808	158,199	142,798	387,097	815,123	1,113,638	671,097	1,745,943	69,200
December	105,769	83,728	23,824	54,310	21,987	115,556	144,221	367,713	831,500	1,097,028	622,067	1,719,095	75,784
Monthly Average	105,567	74,855	23,698	54,105	22,484	114,495	146,657	368,442	861,932	1,095,441	610,526	1,711,967	77,566
Monthly Average (excluding June and December)	105,567	74,855	23,698	54,105	22,484	114,495	146,657	368,442	861,932	1,095,441	610,526	1,711,967	77,566

1921.																	
January	112,234	92,648	24,829	52,910	19,123	170,840	362,616	610,027	1,100,397	695,902	1,794,289	58,330					
February	109,661	84,620	20,217	49,267	18,205	160,768	352,156	822,808	1,064,455	697,361	1,741,810	47,414					
March	109,643	73,785	21,063	46,715	14,897	126,255	326,252	844,458	1,093,676	891,676	1,694,780	42,605					
April	113,203	89,872	26,860	58,022	18,107	136,346	346,071	823,170	989,958	709,019	1,635,977	39,923					
May	110,768	86,012	23,235	56,029	20,229	131,663	344,708	787,637	985,197	718,927	1,715,124	38,950					
June	110,567	112,896	29,332	56,811	18,959	180,053	404,046	795,743	1,029,494	735,563	1,784,847	36,676					
July	110,650	89,548	31,567	60,213	17,572	186,470	393,026	789,977	1,024,602	744,240	1,785,595	34,671					
August	112,745	89,158	38,131	56,334	16,430	125,348	337,561	775,514	1,008,247	737,960	1,768,886	34,403					
September	112,421	84,436	30,840	57,411	16,773	128,166	345,149	767,063	1,013,863	740,582	1,745,907	32,408					
October	108,689	105,350	31,780	58,108	15,789	124,205	354,437	796,643	1,006,928	749,523	1,703,376	31,909					
November	104,959	104,832	28,923	61,215	16,673	127,839	327,443	785,607	1,006,729	785,789	1,736,462	41,578					
December	106,204	132,490	28,986	61,104	19,016	130,830	361,478	736,513	1,044,971	766,078	1,808,065	39,944					
Monthly Average ...	110,744	96,065	27,232	54,829	18,013	134,088	348,822	790,166	1,024,756	728,864	1,753,820	39,410					
Monthly Average (excluding June and December).	111,210	90,741	26,844	54,117	17,918	134,790	348,082	795,073	1,022,240	724,794	1,747,054	39,890					
1922.																	
January	111,713	98,541	34,501	60,085	22,532	134,039	390,470	785,782	1,038,376	783,376	1,801,754	40,801					
February	108,643	81,960	36,827	61,072	22,532	124,045	414,476	752,163	1,027,548	755,694	1,778,232	39,690					
March	110,488	91,267	35,956	62,563	22,493	101,286	413,274	750,723	997,679	730,385	1,741,841	34,204					
April	109,884	86,322	30,844	59,943	22,290	104,138	408,022	750,168	980,782	739,386	1,724,450	36,684					
May	108,694	88,140	33,844	59,535	22,290	104,138	408,022	750,168	980,782	739,386	1,724,450	36,126					
June	99,870	112,935	34,183	64,622	24,417	123,511	427,018	694,710	1,043,695	795,700	1,743,052	33,322					
July	108,300	66,873	27,118	61,209	20,679	118,040	439,570	690,590	1,025,342	705,653	1,710,895	32,854					
August	110,619	81,623	24,915	58,309	25,478	104,869	440,459	698,090	1,028,463	687,656	1,690,110	28,807					
September	108,237	82,801	28,180	58,632	22,638	105,309	430,205	695,805	943,769	674,749	1,638,618	29,664					
October	100,898	88,249	27,748	55,670	23,123	112,207	406,732	705,801	991,364	674,965	1,608,329	34,402					
November	104,823	90,732	26,465	54,264	22,733	106,567	405,577	717,260	984,127	687,443	1,651,668	42,512					
December	102,392	117,719	25,662	58,032	23,777	116,413	397,049	717,268	1,011,315	656,724	1,671,042	47,627					
Monthly Average ...	107,475	92,883	29,675	58,827	23,384	113,398	429,576	711,832	908,346	709,111	1,707,457	39,475					
Monthly Average (excluding June and December).	108,744	88,395	29,627	58,322	23,242	113,011	421,225	712,208	905,544	711,965	1,707,839	35,685					

TABLE 1—continued.

Date.	Cash in Hand.	Balance at Bank of England.	Money at Call.	Money at Short Notice.		Treasury Bills Dis-counted.	Com-mercial Bills Dis-counted.	Invest-ments.	Advances (i.e., Over-drafts).	Current Accounts.	Deposit Accounts.	Total Deposits.	Accept-ances out-standing.
				To the Money Market.	To the Stock Exchange.								
1923.													
January	106,768	82,655	28,047	61,917	21,259	197,154	131,402	291,542	717,458	1,015,491	665,423	1,670,884	48,003
February	104,525	88,981	24,526	58,765	24,942	159,478	111,126	382,184	729,311	975,477	647,207	1,622,684	46,980
March	104,829	71,576	24,059	57,472	27,085	145,827	108,418	369,430	732,999	949,866	659,936	1,579,801	46,605
April	103,446	84,518	28,093	60,304	23,985	138,670	119,286	369,403	729,180	959,869	636,322	1,594,691	42,836
May	105,511	84,217	28,746	59,342	26,345	136,875	117,487	369,109	730,064	952,437	636,956	1,589,393	38,396
June	94,389	99,601	24,436	65,416	29,500	136,286	119,815	373,883	733,832	884,825	649,421	1,628,248	39,028
July	103,835	83,860	21,378	66,277	24,093	144,555	128,825	370,927	728,990	873,019	645,163	1,618,179	39,978
August	105,039	81,977	24,891	59,553	21,130	137,575	120,310	379,603	724,511	945,138	648,978	1,639,368	36,976
September	105,823	83,613	24,794	61,008	20,747	136,868	115,937	379,741	722,574	942,906	648,964	1,610,964	38,345
October	103,617	86,401	22,761	59,349	22,829	151,415	117,378	378,846	730,138	951,960	658,964	1,610,964	38,345
November	103,647	85,537	24,453	63,294	23,072	140,256	117,805	378,879	731,854	941,787	666,552	1,608,339	50,080
December	105,420	114,269	26,265	55,164	23,584	131,094	129,764	378,882	742,837	994,985	669,878	1,664,813	80,232
Monthly Average	103,821	87,267	24,771	60,154	24,482	146,084	119,751	377,611	729,504	966,600	648,504	1,614,105	44,898
Monthly Average (excluding June and December).	104,604	88,838	24,655	60,127	24,070	148,567	118,795	377,806	727,728	960,745	646,876	1,607,620	48,769
1924.													
January	106,545	81,403	23,299	58,990	19,926	143,620	141,818	369,847	743,718	974,752	677,313	1,652,065	69,314
February	102,884	60,783	20,117	52,784	19,203	116,230	123,056	364,175	764,546	937,049	670,061	1,607,110	61,842
March	101,970	78,810	25,943	54,522	17,705	96,512	118,066	378,077	771,585	933,768	656,978	1,589,746	56,969
April	104,923	86,226	25,339	52,621	26,076	99,329	115,183	374,957	771,812	940,094	660,071	1,600,166	54,450
May	103,032	86,237	24,449	54,696	26,625	98,758	116,234	367,737	772,920	940,760	661,367	1,602,127	52,411
June	102,003	108,489	27,629	55,992	22,098	102,885	128,754	364,514	775,166	940,138	667,811	1,621,449	47,146
July	100,894	82,622	22,497	55,960	21,649	108,911	131,623	364,899	775,394	954,827	667,019	1,621,846	46,108
August	105,095	79,465	26,557	56,531	21,784	103,240	120,883	363,374	772,765	951,971	662,121	1,603,792	42,156
September	103,514	77,824	26,096	56,674	22,732	99,491	121,801	363,899	777,654	944,795	669,481	1,604,276	40,064
October	102,609	83,563	24,744	57,994	22,748	107,847	123,550	361,379	786,691	943,471	665,731	1,609,202	50,691
November	103,830	90,516	25,507	56,771	24,661	109,942	117,708	343,553	790,426	935,610	670,847	1,606,457	62,052
December	108,064	114,430	26,061	63,792	26,492	98,228	132,115	387,517	794,807	983,440	671,288	1,654,728	70,907
Monthly Average	103,767	86,276	24,570	57,166	22,791	104,766	125,609	364,702	774,198	960,091	665,716	1,615,747	54,498
Monthly Average (excluding June and December).	108,714	83,040	24,215	56,920	22,290	109,660	124,724	367,440	771,741	943,860	664,969	1,608,679	53,592

1925. January ... February ... March ... April ... May ... June ... July ... August ... September ... October ... November ... December ...	108,867	76,027	23,299	60,872	31,809	103,822	331,501	798,529	955,483	665,741	1,694,224	76,932
	108,275	75,928	24,923	60,352	31,739	103,956	329,474	807,120	957,973	675,120	1,612,058	78,456
	108,316	76,770	23,723	60,968	31,859	103,983	319,849	827,876	952,454	683,204	1,584,688	87,104
	108,200	82,853	23,186	61,028	31,539	103,983	314,831	828,923	956,292	681,734	1,588,926	83,680
	108,537	106,573	24,660	61,268	31,089	104,022	310,184	838,765	885,170	1,672,962	86,931	80,888
	108,789	77,063	27,114	61,263	31,298	110,657	303,508	835,616	935,150	1,623,983	1,607,704	60,386
	108,428	77,794	26,724	61,449	29,049	128,146	295,083	833,141	913,570	1,607,704	1,607,704	67,508
	108,368	82,271	25,043	66,101	27,619	121,531	292,018	819,496	903,865	1,596,914	1,596,914	50,911
	108,460	82,775	24,242	60,438	30,867	129,301	291,238	814,844	910,845	1,584,845	1,584,845	56,315
	101,852	87,479	22,743	57,253	30,964	135,601	294,030	816,981	920,072	1,581,150	1,581,150	66,573
	87,133	115,611	23,904	62,136	35,337	124,709	293,656	834,507	961,725	1,597,173	1,597,173	68,685
	103,662	86,180	24,787	61,108	30,570	127,607	305,419	821,650	923,637	680,162	1,602,999	60,500
104,448	81,209	24,600	60,987	30,039	129,369	306,797	816,968	917,362	678,739	1,597,101	60,898	
1926.												
104,359	76,917	24,987	58,886	32,488	129,800	293,775	883,441	934,248	672,113	1,606,361	67,874	
108,227	82,165	26,505	67,138	31,243	122,535	286,664	844,061	909,157	674,376	1,588,788	82,784	
108,718	77,848	22,948	67,412	31,722	114,185	282,645	865,874	899,162	665,974	1,565,186	58,485	
104,005	78,533	28,019	60,476	30,330	113,643	278,777	851,801	894,923	674,818	1,569,372	56,419	
108,697	81,797	24,116	67,446	30,826	111,211	278,931	852,128	895,697	670,785	1,566,372	51,156	
109,848	106,025	25,420	63,168	31,028	104,959	278,098	861,687	942,692	685,008	1,627,700	46,949	
100,089	80,484	25,545	72,512	31,928	119,778	282,114	852,639	931,346	685,023	1,620,269	44,240	
102,249	87,672	23,471	64,148	30,705	123,093	282,114	865,991	921,670	691,437	1,613,107	43,177	
104,920	88,057	23,012	88,294	29,598	100,385	284,647	865,991	908,388	693,806	1,603,194	43,465	
105,298	76,957	24,904	69,042	33,434	95,168	288,157	865,381	929,399	700,335	1,629,604	47,663	
104,301	78,872	23,164	66,283	33,617	117,949	102,354	288,025	920,395	710,378	1,631,274	51,903	
96,154	119,743	27,400	62,989	36,949	95,033	286,771	837,258	889,141	720,861	1,690,002	51,779	
103,072	86,076	24,960	68,149	32,079	109,938	107,799	284,456	858,039	921,408	1,608,374	52,068	
103,736	80,715	24,670	63,164	31,690	99,962	106,369	284,760	854,768	914,307	1,598,379	52,608	

TABLE 1—continued.

Date.	Cash in Hand.	Balance at Bank of England.	Money at Short Notice.		Treasury Bills Dis-counted.	Com-mercial Bills Dis-counted.	Invest-ments.	Advances (In-cludes Over-drafts).	Current Accounts.	Deposit Accounts.	Total Deposits.	Acceptances out-standing.
			To the Stock Market.	To the Ex-change.								
1927.												
January	104,260	80,876	68,654	34,781	135,512	100,948	284,527	885,006	987,493	725,165	1,662,658	51,656
February	104,663	83,106	64,224	33,901	121,862	93,226	276,155	865,869	905,344	728,229	1,625,873	46,271
March	104,456	74,416	68,616	36,440	101,498	88,067	273,983	837,612	866,734	715,468	1,612,222	51,661
April	106,219	83,458	68,568	37,076	97,337	97,737	270,688	892,828	904,421	725,208	1,626,629	51,994
May	104,119	81,568	66,345	40,256	87,911	106,727	270,858	896,992	908,214	720,139	1,628,529	50,890
June	106,440	109,607	78,857	41,380	93,480	96,219	270,045	909,376	961,504	727,671	1,688,976	48,849
July	108,225	82,523	25,639	38,269	112,059	105,869	272,568	902,061	929,824	715,622	1,653,666	46,957
August	105,302	75,737	20,445	39,113	105,201	97,247	270,794	901,608	929,824	719,444	1,654,668	44,776
September	109,323	77,289	24,920	40,472	113,938	94,664	268,972	909,141	933,532	723,138	1,664,668	44,599
October	107,664	76,638	51,897	43,286	134,127	100,102	272,846	901,479	932,785	732,785	1,666,836	47,456
November	107,510	71,908	23,623	41,580	129,782	99,355	270,302	900,043	933,543	742,439	1,675,987	52,775
December	94,982	128,865	59,821	47,023	117,828	100,986	268,805	907,459	963,379	752,018	1,735,397	53,140
Monthly Average	105,091	85,344	75,363	39,548	112,550	98,421	272,552	899,193	932,123	726,468	1,658,611	49,464
Monthly Average (excluding June and December).	106,067	78,746	74,066	38,617	113,930	96,983	273,177	897,343	924,060	723,796	1,647,656	49,178
1926.												
January	107,182	77,424	79,965	45,084	127,458	117,976	279,039	918,533	967,014	748,990	1,715,904	54,282
February	105,189	70,628	77,136	47,456	100,228	105,339	289,982	908,633	928,591	728,129	1,661,680	57,495
March	105,719	70,608	76,612	60,879	80,549	104,310	273,084	924,217	920,241	729,994	1,664,686	60,264
April	103,340	71,977	51,876	51,856	86,961	109,813	271,260	926,217	930,898	736,911	1,668,625	60,804
May	103,224	76,967	76,794	49,221	76,072	116,384	271,072	924,184	921,921	736,816	1,664,637	60,804
June	88,961	106,361	74,219	46,232	100,822	122,890	266,147	927,669	977,356	753,297	1,730,635	62,507
July	100,847	82,667	51,945	44,111	121,410	133,919	271,427	922,515	908,978	759,963	1,728,941	67,748
August	102,742	81,682	78,234	42,484	120,903	125,198	272,973	922,991	943,960	763,983	1,708,382	64,928
September	107,866	77,680	76,498	45,866	121,972	117,775	280,766	934,248	945,622	763,710	1,726,682	68,976
October	106,258	86,012	76,039	48,211	116,562	116,562	279,049	936,248	956,998	795,465	1,760,639	70,535
November	108,328	86,202	74,287	49,140	120,466	124,677	271,168	936,466	967,960	771,960	1,727,173	75,535
December	106,411	118,267	77,190	50,583	118,670	124,946	281,036	943,414	1,020,159	789,638	1,816,227	83,346
Monthly Average	104,457	83,618	77,667	47,951	107,717	118,208	275,334	923,553	953,745	755,197	1,708,942	65,921
Monthly Average (excluding June and December).	105,011	77,877	78,084	47,659	107,311	117,072	275,663	921,164	944,141	752,003	1,686,144	63,800

1929.	January	81,149	27,019	76,997	46,989	132,614	187,852	290,727	947,628	988,885	788,771	1,775,609	85,483
	February	80,859	26,652	66,862	45,202	112,247	185,077	275,008	965,716	988,079	790,468	1,744,847	85,884
	March	83,056	23,807	66,178	45,178	76,365	124,229	275,449	985,910	993,176	784,086	1,717,940	81,214
	April	80,672	20,209	47,989	45,909	74,399	121,447	277,793	970,298	993,374	790,218	1,708,889	78,387
	May	82,447	30,305	72,284	47,436	75,929	121,601	276,684	978,568	978,181	793,590	1,708,685	74,584
	June	81,516	27,869	77,724	47,434	80,688	135,577	275,867	978,364	954,707	793,590	1,749,995	68,917
	July	80,050	26,462	73,295	47,844	106,356	165,519	272,010	946,969	924,640	797,014	1,724,653	64,640
	August	82,417	25,953	71,293	48,227	100,951	171,600	278,578	960,183	931,210	798,475	1,729,985	64,723
	September	80,619	25,542	72,417	47,582	100,951	171,600	278,578	960,183	931,210	798,475	1,729,985	64,723
	October	84,483	32,553	81,293	48,770	113,004	274,343	958,207	928,630	814,637	728,836	1,734,673	65,939
	November	85,534	34,483	88,705	50,160	109,972	274,343	958,207	928,630	814,637	728,836	1,734,673	65,939
	December	81,553	31,409	75,592	35,770	107,552	119,937	466,785	959,408	943,139	818,755	1,721,861	67,832
	Monthly Average ...	110,067	34,309	83,042	32,523	87,769	118,788	297,433	963,976	962,243	967,660	815,106	1,772,896	66,610
Monthly Average ...	104,356	28,906	48,376	98,304	192,851	275,008	797,890	940,162	962,423	797,890	1,738,042	73,561	
Monthly Average (exclud- ing June and December).	105,087	28,411	44,055	100,120	128,917	275,713	962,658	935,888	796,423	1,731,806	74,158		
1930.	January	75,500	40,572	78,007	31,718	111,972	124,952	289,582	955,561	915,872	814,292	1,732,784	64,698
	February	71,500	32,633	70,180	31,579	90,194	113,425	286,063	960,004	875,093	802,595	1,676,297	64,410
	March	76,588	30,468	76,838	34,452	83,134	97,392	262,043	961,080	879,706	780,991	1,657,237	64,446
	April	74,854	32,431	75,820	33,445	89,104	131,487	285,221	948,701	861,143	797,815	1,698,558	66,999
	May	82,045	29,957	72,351	36,943	97,140	152,177	299,452	939,731	897,459	816,560	1,717,049	64,582
	June	81,140	30,015	79,560	32,369	111,841	140,784	270,539	954,123	953,383	826,999	1,761,252	59,308
	July	83,147	32,025	80,974	27,189	138,456	187,764	281,082	939,320	828,161	828,161	1,764,501	56,190
	August	83,203	31,563	83,203	23,262	139,346	132,941	290,637	948,659	915,825	821,343	1,767,168	52,448
	September	84,789	33,215	82,578	33,541	165,563	123,831	284,243	913,071	923,942	820,921	1,748,863	50,865
	October	84,789	35,045	90,184	22,230	164,478	125,029	298,597	906,495	923,760	837,517	1,766,577	50,865
	November	87,812	30,672	83,208	22,463	160,642	127,172	302,143	904,057	924,903	844,126	1,769,029	51,362
	December	82,663	36,354	79,171	23,622	161,839	119,359	308,431	904,562	991,821	846,503	1,838,424	51,784
	Monthly Average ...	84,535	33,079	80,071	28,476	128,642	137,198	281,529	933,432	920,784	820,031	1,740,815	57,980
Monthly Average (exclud- ing June and December).	78,362	32,860	80,212	28,592	125,003	126,626	279,937	934,240	910,322	816,667	1,727,010	58,469	
1931.	January	84,222	37,478	86,947	22,042	197,082	121,849	326,290	891,943	961,984	842,105	1,804,089	50,222
	February	82,876	20,946	62,272	19,813	165,999	112,138	338,690	899,561	912,725	829,561	1,742,289	49,356
	March	68,868	25,231	67,896	22,269	128,780	96,863	384,554	915,355	895,201	798,040	1,693,241	47,407

TABLE 2.—ANALYSIS OF THE MONTHLY RETURNS OF SIX SCOTTISH BANKS.*
(£000 throughout).

Date.	Cash in Hand.	Balances at Bank of England.	Money at Call.	Money at Short Notice.		Treasury Bills Discounted.	Commercial Bills Discounted.	Investments.	Advances (i.e., Loans and Overdrafts).	Current Accounts.	Deposit Accounts.	Total Deposits.	Acceptances outstanding.
				To the Money Market.	To the Stock Exchange.								
1919.													
January	10,206	2,872	1,566	3,112	274	29,116	2,991	34,518	21,590	30,791	54,346	85,137	2,187
February	9,508	2,746	1,460	1,937	270	22,661	3,176	35,273	22,939	26,855	54,047	80,925	2,059
March	10,015	2,740	1,451	3,125	271	20,589	3,560	35,363	23,912	25,930	54,700	80,630	2,169
April	10,660	2,569	1,418	4,080	276	23,844	2,611	35,323	23,858	27,048	57,250	84,898	2,204
May	11,093	2,078	1,308	2,152	255	26,085	3,256	35,235	24,201	27,944	57,408	85,352	1,969
June	11,234	2,052	1,371	2,407	190	21,603	3,484	38,335	25,531	30,835	59,628	90,483	2,280
July	11,398	2,018	1,366	2,074	195	12,017	4,073	40,791	28,777	31,632	59,377	90,809	2,460
August	10,882	2,017	1,360	4,105	187	9,124	4,078	43,297	29,435	27,742	60,016	88,213	2,448
September	10,634	1,863	1,300	4,349	193	13,571	3,601	43,144	30,232	27,742	62,160	90,902	2,338
October	11,012	1,520	1,804	4,834	195	17,594	3,817	42,915	29,281	28,745	62,806	91,651	2,419
November	11,147	1,531	1,804	3,075	159	19,324	4,564	42,858	30,901	29,021	64,145	92,976	2,976
December	11,253	1,539	1,815	2,938	143	19,968	4,755	42,854	31,597	28,632	66,361	94,993	2,966
Monthly Average	10,786	1,985	732	3,761	217	19,621	3,623	38,922	28,797	28,681	59,322	88,003	2,400
Monthly Average (excluding June and December).	10,694	2,121	820	3,979	227	19,368	3,526	38,878	29,488	28,471	58,587	87,068	2,325
1920.													
January	11,074	482	983	4,205	126	20,747	5,551	42,925	31,544	27,990	66,242	94,241	3,214
February	10,731	424	1,576	4,045	107	17,946	5,547	40,377	34,829	27,025	66,021	93,046	2,852
March	14,549	687	1,894	7,611	483	16,152	8,365	58,437	53,795	44,565	87,875	132,243	3,023
April	15,097	1,213	2,292	8,504	489	15,035	8,070	59,233	52,712	45,150	89,045	134,215	3,137
May	19,729	1,213	2,718	10,001	794	21,900	13,404	64,898	65,567	59,959	170,302	267,261	3,386
June	20,089	928	2,330	9,534	757	23,470	18,458	64,409	68,644	54,931	119,890	168,651	3,642
July	20,308	948	2,562	9,470	824	22,950	13,978	64,580	69,479	55,757	114,996	170,758	3,211
August	19,392	1,089	2,066	7,940	875	20,239	14,441	64,291	72,605	62,809	118,500	169,309	3,098
September	19,308	1,077	2,210	8,567	758	21,911	12,964	64,268	73,801	58,640	118,899	172,589	3,932
October	18,983	1,077	2,311	10,472	722	20,639	14,323	63,108	73,122	53,651	120,299	178,850	3,269
November	19,835	1,085	2,523	9,662	792	23,467	14,538	63,137	75,449	55,214	120,057	175,271	3,081
December	19,803	1,189	2,257	11,118	800	25,669	14,927	62,020	70,977	55,129	121,864	176,693	2,741
Monthly Average	17,412	954	2,144	8,521	631	20,844	11,794	63,280	81,840	48,569	103,776	152,345	3,170
Monthly Average (excluding June and December).	16,905	933	2,114	8,160	602	20,099	11,298	67,283	80,246	47,277	101,006	148,283	3,160

* Up to Feb., 1920, inclusive the figures cover three banks only. For March and April, 1920, they cover four banks. For May to Dec., 1920, inclusive they cover five banks, and from Jan., 1921, onwards they cover six banks.

1921.	January	1,085	6,468	11,017	792	34,616	16,173	73,335	78,041	64,255	142,811	207,036	8,860
	February	871	4,244	6,493	756	33,670	15,773	72,250	80,366	59,176	142,945	202,121	8,859
	March	896	4,127	9,073	766	31,919	14,614	72,176	81,913	57,921	143,881	201,802	8,687
	April	22,381	1,131	10,797	781	33,747	13,094	72,149	80,970	66,807	144,270	201,077	8,344
	May	22,323	4,152	12,956	784	38,908	13,846	72,403	77,851	58,968	140,835	205,803	8,001
	June	1,185	4,500	8,025	685	33,923	13,400	74,071	77,851	58,433	151,200	209,633	8,840
	July	21,973	3,602	12,658	730	43,033	13,751	75,017	74,374	65,287	152,571	208,084	2,963
	August	21,594	3,841	9,728	754	37,793	13,721	75,906	74,327	65,287	152,571	208,084	2,963
	September	20,477	3,450	10,227	689	50,448	12,330	75,717	71,432	54,460	154,706	208,751	2,748
	October	20,293	4,885	10,880	712	46,352	11,966	77,071	72,320	54,356	155,026	210,282	2,748
	November	20,783	4,873	10,904	679	40,044	11,488	80,984	79,065	57,123	155,544	212,672	2,941
	December	20,025	4,819	12,584	630	40,815	12,005	82,478	70,149	56,730	155,457	212,193	2,937
	Monthly Average ...												
	21,783	4,432	10,880	726	41,490	13,348	76,213	75,919	57,300	149,979	207,280	8,116	
Monthly Average (exclud- ing June and December).													
	21,879	4,366	10,755	739	40,714	13,477	74,901	76,302	57,243	149,310	206,553	8,161	
1922.	January	914	5,645	10,680	806	43,920	11,889	90,529	69,415	59,276	156,958	216,234	2,774
	February	920	4,647	11,314	724	39,098	10,925	90,949	68,247	54,564	155,438	210,002	2,662
	March	780	3,317	10,232	953	36,292	11,942	93,247	66,236	54,436	154,284	208,720	3,039
	April	1,299	6,147	11,693	1,008	34,348	11,421	95,447	64,320	55,447	155,210	210,663	3,058
	May	19,859	897	9,576	1,180	30,392	10,743	108,890	66,271	59,013	152,580	211,543	3,858
	June	19,856	877	9,298	982	27,740	10,920	105,550	65,057	66,674	151,868	207,542	3,247
	July	19,656	806	7,950	806	23,487	11,537	107,875	63,529	66,642	147,405	203,047	2,337
	August	20,004	2,914	7,950	1,062	21,738	10,644	104,846	64,197	54,900	144,498	199,307	3,266
	September	18,958	2,972	9,523	889	19,561	11,022	103,782	66,515	53,633	143,016	196,649	3,908
	October	18,786	3,384	8,117	967	22,213	11,134	106,462	65,283	66,553	141,155	198,155	3,452
	November	18,985	2,457	10,196	866	19,917	12,896	109,334	69,751	66,553	138,134	197,885	3,500
	December	1,086	8,729	8,291	806	18,917	14,872	96,667	80,984	68,489	136,062	194,541	3,768
	921	3,511	10,094	10,094	797	19,250	14,872	96,667	80,984	68,489	136,062	194,541	3,768
Monthly Average ...													
	19,262	3,982	9,831	931	28,329	11,640	99,498	65,957	66,432	148,083	204,516	8,170	
Monthly Averages (exclud- ing June and December).													
	19,221	4,085	9,767	930	29,295	11,418	99,176	66,076	66,302	148,908	205,210	8,103	

TABLE 2—continued.

Date.	Cash in Hand.	Balance at Bank of England.	Money at Short Notice.		Treasury Bills Discounted.	Commercial Bills Discounted.	Investments.	Advances (i.e., Loans and Over-drafts).	Current Accounts.	Deposit Accounts.	Total Deposits.	Acceptances outstanding.
			To the Money Market.	To the Stock Exchange.								
1923.												
January	18,221	1,009	4,441	9,107	896	18,079	96,449	65,776	59,615	133,018	196,533	3,825
February	17,900	962	3,951	10,177	715	11,387	93,548	60,797	57,211	130,684	186,875	3,809
March	17,797	822	3,165	8,351	1,955	11,419	90,465	69,236	55,018	126,951	181,969	5,016
April	18,748	1,256	4,880	9,351	790	13,194	89,084	68,042	56,220	126,699	182,919	2,965
May	18,902	993	4,755	8,785	768	11,667	88,856	68,837	56,488	123,701	183,139	2,947
June	19,248	977	3,336	8,830	455	12,460	89,351	69,408	57,731	122,288	180,010	3,162
July	18,998	1,039	3,051	8,933	734	11,958	88,520	69,812	57,059	121,155	178,214	3,064
August	18,328	994	3,354	10,734	689	11,650	86,509	69,332	55,515	121,481	177,000	2,992
September	18,054	939	4,072	9,957	736	11,804	85,942	68,576	54,666	121,475	176,841	2,993
October	17,743	1,263	3,804	11,757	540	11,879	83,132	69,540	54,670	122,162	176,832	2,958
November	18,022	985	3,053	10,737	640	11,603	84,314	70,090	56,673	120,620	177,293	2,964
December	18,137	1,194	3,776	11,669	448	12,098	85,362	68,108	58,228	119,939	178,167	3,318
Monthly Average ...	18,334	1,032	3,682	9,843	683	13,424	88,473	68,663	56,828	124,114	180,942	3,161
Monthly Average (excluding June and December).	18,286	1,021	3,647	9,773	710	13,521	88,691	68,645	56,598	124,714	181,312	3,138
1924.												
January	17,458	810	3,393	8,088	529	14,735	86,294	66,924	57,826	118,940	176,772	4,137
February	17,956	913	3,471	8,531	474	14,929	86,832	67,926	59,653	117,900	177,533	4,122
March	17,538	739	3,070	8,326	470	10,305	85,991	69,274	56,378	117,669	173,947	3,842
April	17,632	1,195	3,698	10,547	556	12,048	85,291	71,184	57,710	117,269	175,015	3,403
May	18,322	957	3,465	10,390	551	10,730	85,615	72,232	59,619	115,565	176,084	3,868
June	18,669	952	3,295	9,776	473	10,885	85,996	73,500	59,006	117,545	176,551	3,199
July	18,954	847	3,419	9,758	543	10,681	86,713	73,145	58,165	116,174	174,339	2,872
August	18,224	891	3,281	9,568	539	10,480	86,713	73,742	55,290	116,233	171,523	2,788
September	17,957	891	4,560	11,080	534	10,130	82,020	75,009	56,471	116,496	172,997	3,023
October	18,477	1,372	4,260	11,412	593	10,213	79,982	74,640	58,964	117,134	176,098	3,455
November	18,157	1,043	3,861	10,185	665	10,003	79,596	75,028	61,016	115,403	176,509	4,202
December	18,224	869	3,669	9,951	714	16,306	80,197	74,857	63,872	114,242	178,114	4,827
Monthly Average ...	18,011	947	4,124	9,391	658	12,077	83,955	72,288	58,656	116,716	175,375	3,560
Monthly Average (excluding June and December).	17,925	962	4,265	9,277	645	11,797	84,127	71,910	58,100	116,881	174,981	3,470

1925.	17,684	912	4,525	8,606	704	11,677	10,931	81,261	75,759	68,128	112,918	174,941	4,933
January	17,330	860	3,635	7,429	712	6,830	10,930	81,300	77,121	69,000	112,908	171,866	4,656
February	17,343	771	3,469	8,382	688	8,108	10,213	78,350	78,140	67,244	111,548	168,692	3,370
March	17,960	985	3,745	8,390	871	6,826	9,895	80,096	77,729	67,982	112,552	170,634	3,247
April	18,343	770	3,198	6,872	952	6,465	9,551	81,168	77,970	68,936	111,417	170,053	2,857
May	18,110	980	2,967	6,428	740	5,443	9,904	80,717	80,914	66,766	111,662	170,317	2,847
June	18,123	899	3,556	7,276	1,179	7,025	9,693	79,825	80,630	67,705	110,684	168,589	2,435
July	17,630	921	2,999	6,972	1,143	7,055	9,339	78,147	79,201	66,137	111,124	167,261	2,609
August	17,370	908	3,496	10,495	1,142	10,581	9,064	76,331	76,802	66,878	113,848	173,342	3,095
September	17,360	908	3,496	10,560	1,180	13,720	9,116	75,894	76,263	66,878	113,848	173,342	3,095
October	17,701	795	2,993	8,660	1,004	14,800	9,282	76,254	80,840	60,024	112,994	173,018	4,904
November	17,657	737	3,060	9,331	987	14,805	9,307	76,853	80,237	60,838	112,168	173,006	5,420
December	17,657	737	3,060	9,331	987	14,805	9,307	76,853	80,237	60,838	112,168	173,006	5,420
Monthly Average	17,705	897	3,426	8,276	940	10,144	9,696	78,998	78,967	68,784	112,290	171,074	3,674
Monthly Average (excluding June and December).	17,470	904	3,508	8,355	955	9,848	9,712	78,780	78,646	68,582	112,375	170,957	3,612
1926.	17,161	801	4,167	7,230	1,086	10,249	9,591	75,606	81,204	58,672	109,704	168,376	5,306
January	16,228	860	2,867	6,989	1,084	7,238	8,474	74,911	81,767	54,497	107,303	161,800	4,522
February	16,476	970	3,487	8,053	991	6,448	8,619	71,756	88,069	57,091	106,811	163,902	3,990
March	16,949	1,117	4,094	7,714	1,016	7,071	8,658	74,513	81,240	57,715	108,392	166,107	3,582
April	18,075	1,011	3,751	7,723	998	6,606	8,532	74,688	85,075	60,090	107,874	168,054	3,305
May	17,055	802	4,085	8,452	947	12,300	8,098	75,159	82,989	60,565	109,607	170,072	3,227
June	17,617	800	3,748	7,888	1,005	12,078	8,093	75,399	82,989	59,681	110,003	169,484	3,271
July	16,793	808	3,191	6,402	914	11,150	8,300	76,436	82,082	57,000	110,358	167,958	3,642
August	16,944	897	3,539	7,100	883	10,874	7,920	76,450	82,003	56,968	111,614	168,682	2,964
September	16,718	1,238	4,579	9,087	906	11,835	8,142	72,297	83,383	58,283	111,864	170,127	3,259
October	17,069	859	3,539	8,141	1,084	12,980	8,070	71,836	86,282	58,605	110,857	170,762	3,463
November	16,609	808	4,477	10,247	1,013	13,168	8,215	72,060	84,638	60,390	110,830	171,256	3,718
December	16,609	808	4,477	10,247	1,013	13,168	8,215	72,060	84,638	60,390	110,830	171,256	3,718
Monthly Average	17,000	914	3,809	7,919	980	10,464	8,379	74,443	82,061	58,444	109,810	168,054	3,689
Monthly Average (excluding June and December).	16,973	936	3,786	7,683	992	10,010	8,423	74,610	82,560	58,037	109,498	167,536	3,792

TABLE 2—continued.

Date.	Cash in Hand.	Balance at Bank of England.	Money at Call.		Money at Short Notice.		Treasury Bills Discounted.	Commercial Bills Discounted.	Investments.	Advances (i.e., Loans and Overdrafts).	Current Accounts.	Deposit Accounts.	Total Deposits.	Acceptances outstanding.
			Money at Call.	Balance at Bank of England.	To the Money Market.	To the Stock Exchange.								
1927.														
January	16,405	804	4,012	1,116	8,229	8,229	8,229	88,198	72,558	88,198	59,233	108,597	167,830	8,862
February	17,095	874	3,265	1,181	11,499	7,591	10,784	89,080	72,785	89,080	57,323	108,001	183,390	4,125
March	16,936	814	3,715	1,213	7,432	7,432	10,784	84,481	74,429	84,481	58,438	108,551	190,986	4,060
April	16,846	726	4,201	1,270	8,040	7,361	10,784	80,722	75,849	80,722	59,468	108,493	199,959	3,802
May	17,512	868	3,453	1,278	7,885	7,361	10,784	85,670	75,029	85,670	61,019	109,582	187,609	3,841
June	17,478	927	3,187	1,481	7,293	7,293	10,784	86,802	74,997	86,802	62,119	107,438	189,557	3,838
July	17,840	871	3,600	1,503	7,595	7,595	10,784	87,381	73,664	87,381	61,138	108,480	188,921	3,416
August	16,932	910	4,248	1,630	7,920	8,009	10,784	87,098	72,273	87,098	59,724	108,541	188,294	3,781
September	16,910	869	4,154	1,573	7,335	7,335	10,784	87,247	71,268	87,247	61,891	108,540	189,410	3,981
October	17,019	1,149	5,266	1,490	10,546	7,992	10,784	86,324	71,581	86,324	63,569	108,138	171,693	3,681
November	17,365	1,738	3,908	1,255	10,270	8,255	10,784	89,193	72,388	89,193	65,728	107,373	173,084	3,983
December	17,671	821	5,114	1,383	11,221	8,672	10,784	87,917	71,584	87,917	65,811	107,059	172,870	4,324
Monthly Average	16,968	808	4,085	1,349	8,320	7,821	10,784	86,021	73,201	86,021	61,211	107,399	168,610	3,860
Monthly Average (excluding June and December)	16,892	865	4,072	1,362	8,095	7,880	10,784	85,758	73,183	85,758	60,660	107,429	168,090	3,774
1928.														
January	17,018	777	4,692	1,188	8,980	9,175	10,784	84,928	72,029	84,928	64,223	108,491	169,714	4,517
February	16,525	903	3,413	1,327	6,235	6,235	10,784	87,713	72,620	87,713	60,500	104,260	190,760	4,176
March	17,550	801	4,273	1,340	4,973	8,133	10,784	89,648	70,546	89,648	60,313	105,552	185,760	4,572
April	17,490	958	5,662	1,263	8,540	7,868	10,784	89,722	70,338	89,722	62,888	108,824	171,210	4,004
May	17,063	940	3,794	1,458	8,580	8,580	10,784	90,815	71,465	90,815	65,119	109,573	171,687	3,523
June	18,008	776	4,387	1,480	8,225	8,225	10,784	91,375	71,465	91,375	65,454	107,700	173,154	3,600
July	17,957	910	3,633	1,481	7,570	8,440	10,784	93,144	70,714	93,144	63,388	108,499	189,888	3,456
August	17,330	928	3,503	1,495	7,505	8,474	10,784	91,266	69,362	91,266	62,823	107,993	170,010	3,402
September	17,117	860	4,077	1,457	6,594	8,758	10,784	91,591	69,960	91,591	62,485	107,998	170,688	3,378
October	17,143	1,143	5,062	1,437	6,532	9,582	10,784	88,247	67,684	88,247	68,247	108,748	173,993	4,444
November	17,440	708	4,893	1,601	6,518	10,005	10,784	87,345	67,293	87,345	67,345	108,902	173,637	4,628
December	17,078	883	4,931	1,622	10,990	9,731	10,784	85,560	66,530	85,560	67,308	108,648	175,852	4,808
Monthly Average	17,306	880	4,366	1,448	8,070	8,768	10,784	86,602	69,905	86,602	64,148	107,290	171,438	4,152
Monthly Average (excluding June and December)	17,269	892	4,331	1,484	7,564	8,744	10,784	86,449	70,087	86,449	63,702	107,113	170,915	4,140

1929.	17,378	774	5,775	8,177	1,706	11,328	9,267	65,199	94,468	57,192	106,853	173,645	5,276
January	16,930	749	4,964	9,718	1,774	8,728	9,391	64,189	93,243	62,082	106,835	168,867	5,762
February	16,303	774	4,434	7,919	1,471	8,558	8,726	64,108	95,833	60,203	108,035	166,287	5,142
March	16,634	860	4,731	10,756	1,343	8,693	9,613	64,209	94,830	60,692	111,005	171,697	4,961
April	17,140	860	3,396	8,358	1,338	9,255	9,476	65,438	96,876	61,062	109,521	170,583	4,729
May	17,085	883	4,868	7,638	1,369	9,266	8,657	65,640	97,779	62,062	110,803	173,385	4,828
June	17,367	763	3,457	9,248	1,382	10,220	8,908	66,909	99,072	62,658	111,703	173,782	4,958
July	16,968	806	3,993	8,836	1,357	9,329	8,493	66,232	98,376	62,989	111,842	174,164	4,849
August	16,561	831	4,048	8,255	1,364	9,315	9,651	66,339	98,691	61,177	112,487	173,664	4,115
September	16,839	1,239	4,968	10,260	1,396	12,247	9,250	66,389	97,034	62,768	114,167	176,993	4,237
October	16,846	734	3,110	8,577	1,211	12,671	8,745	66,052	100,132	63,177	113,270	176,447	4,607
November	16,960	953	3,623	8,920	985	13,698	8,049	65,365	98,664	63,227	113,051	176,308	4,943
December	16,961	840	4,251	8,905	1,882	10,752	8,976	65,410	97,095	62,429	110,667	178,096	4,788
Monthly Average ...	16,961	840	4,251	8,905	1,882	10,752	8,976	65,410	97,095	62,429	110,667	178,096	4,788
Monthly Average (excluding June and December).	16,887	829	4,290	9,030	1,423	10,246	9,110	65,402	96,869	62,333	110,412	172,745	4,788
1930.	16,313	716	5,928	7,978	1,610	11,250	7,801	65,062	98,820	64,543	111,585	176,078	4,486
January	15,810	726	4,084	6,179	983	6,066	7,489	66,180	89,576	59,582	108,768	167,359	4,307
February	16,139	776	3,743	8,664	958	6,646	7,793	65,104	89,454	57,601	109,794	167,448	4,177
March	16,909	822	4,612	9,362	976	4,975	8,860	65,582	90,588	60,082	109,051	160,143	5,051
April	17,679	763	3,940	10,329	1,086	3,280	7,944	65,838	101,928	63,680	108,463	172,193	8,043
May	17,632	687	4,561	11,347	994	6,526	8,279	66,338	98,659	64,962	108,149	172,136	8,247
June	17,720	850	4,180	10,931	546	7,227	6,004	66,636	88,547	65,151	109,566	174,496	3,825
July	17,374	1,157	6,452	10,492	776	7,605	7,710	67,825	88,452	66,852	107,782	174,496	3,689
August	16,924	767	4,431	14,086	956	8,975	8,653	70,212	86,186	70,463	116,599	174,773	4,066
September	16,758	1,298	7,406	11,987	827	12,596	8,226	73,140	83,729	70,463	112,395	169,648	4,010
October	17,169	873	6,471	10,845	626	14,142	8,786	77,823	83,786	71,067	114,595	183,507	4,176
November	16,952	924	6,980	8,504	966	14,517	7,672	79,458	91,030	72,037	110,233	182,270	3,930
December	16,940	860	5,147	10,042	538	8,801	7,933	69,145	97,078	65,432	109,569	175,021	4,043
Monthly Average ...	16,940	860	5,147	10,042	538	8,801	7,933	69,145	97,078	65,432	109,569	175,021	4,043
Monthly Average (excluding June and December).	16,868	870	5,022	10,065	589	8,457	7,924	68,403	96,147	64,817	109,670	174,486	4,074
1931.	16,099	738	6,898	8,645	657	12,039	7,605	80,291	90,158	70,904	110,641	181,546	3,937
January	15,698	795	5,237	5,024	565	9,622	7,834	81,216	91,842	65,813	107,655	173,308	3,640
February	15,753	759	5,968	7,856	581	7,974	7,610	80,796	92,690	66,617	108,725	174,842	3,050
March	15,753	759	5,968	7,856	581	7,974	7,610	80,796	92,690	66,617	108,725	174,842	3,050

TABLE 3.—LONDON CLEARING BANKS. SUMMARY OF MONTHLY AVERAGES (12 MONTHS) SHOWN IN TABLE 1.
(£ millions throughout.)

Year.	Cash in Hand.	Balance at Bank of England.	Money at Call.	Money at Short Notice.		Treasury Bills Dis- counted.	Com- mercial Bills Dis- counted.	Invest- ments.	Advances (i.e., Loans and Over- drafts).	Current Accounts.	Deposit Accounts.	Total Deposits.	Accep- tances out- standing.
				To the Money Market.	To the Stock Ex- change.								
1919	112.4	103.9	22.9	90.9	17.7	159.2	106.8	351.4	579.6	1,015.9	494.8	1,510.7	61.6
1920	105.8	83.7	23.8	54.3	22.0	115.6	144.2	367.7	831.6	1,097.6	622.1	1,719.7	75.8
1921	110.7	96.1	27.2	54.8	18.0	224.6	134.1	348.8	790.2	1,024.8	728.9	1,753.6	39.4
1922	107.5	92.9	29.7	58.8	23.4	208.0	113.3	420.6	711.8	998.3	709.1	1,707.5	36.5
1923	103.8	87.3	24.8	60.2	24.5	146.1	119.8	377.6	729.5	965.6	648.5	1,614.1	44.7
1924	103.8	88.3	24.6	57.2	22.8	104.8	125.5	364.7	774.2	960.0	665.7	1,615.7	54.5
1925	103.7	86.2	24.8	61.1	30.6	91.0	127.6	305.4	821.6	922.5	680.2	1,602.7	60.5
1926	103.1	86.1	25.0	63.1	32.1	100.9	107.8	284.5	858.0	921.4	687.5	1,608.9	52.1
1927	105.1	85.3	25.2	75.4	39.5	112.6	98.4	272.6	899.2	932.1	726.5	1,658.6	49.5
1928	104.5	83.6	28.4	77.7	48.0	107.7	118.2	275.3	923.6	953.7	765.2	1,708.9	65.3
1929	104.4	82.9	28.9	76.0	43.4	98.3	122.9	275.0	964.0	940.2	787.9	1,739.0	73.6
1930	103.6	84.5	33.1	80.1	28.5	128.6	127.2	281.5	933.4	920.8	820.0	1,740.8	58.0

TABLE 4.—LONDON CLEARING BANKS. SUMMARY OF MONTHLY AVERAGES EXPRESSED AS AN INDEX NUMBER WITH 1924 AS BASE=100.

1919	108.3	117.6	93.3	159.0	77.7	152.0	85.1	96.4	74.9	106.9	74.3	93.5	112.8
1920	101.9	94.8	97.0	95.0	96.5	110.3	114.9	100.8	107.4	115.5	93.4	106.4	139.1
1921	106.7	108.8	110.8	95.9	79.0	214.3	108.8	95.6	102.1	107.9	109.5	108.5	72.3
1922	103.6	105.2	120.8	102.9	102.6	198.5	90.3	115.3	91.9	106.1	106.5	105.7	66.9
1923	100.1	98.9	100.8	105.2	107.4	139.4	95.4	103.5	94.2	101.6	97.4	99.9	82.0
1924	100	100	100	100	100	100	100	100	100	100	100	100	100
1925	99.9	97.6	100.9	106.9	134.1	86.8	101.7	83.7	106.1	97.1	102.2	99.2	111.0
1926	99.3	97.5	101.6	110.5	140.8	96.3	85.9	78.0	110.8	97.0	103.3	99.6	95.5
1927	101.3	96.7	102.7	131.8	173.5	107.4	78.4	74.7	116.1	98.1	109.1	102.7	90.8
1928	100.7	94.7	115.7	135.9	210.4	102.8	84.2	75.5	119.3	100.4	113.4	105.8	119.9
1929	100.6	93.9	117.6	132.9	190.3	93.8	97.9	75.4	124.5	98.0	119.9	107.6	136.0
1930	99.8	95.8	134.6	140.1	124.9	122.8	101.3	77.2	120.6	98.9	123.2	107.7	106.4

TABLE 5.—SCOTTISH BANKS. SUMMARY OF MONTHLY AVERAGES (12 MONTHS) SHOWN IN TABLE 2.
(£ millions throughout.)

1919	...	...	2.0	.7	3.8	.2	19.6	3.6	39.0	26.8	28.7	59.3	88.0	2.4
1920	...	...	1.0	2.1	8.5	.6	20.8	11.8	58.3	61.8	48.6	103.8	152.3	3.2
1921	...	...	1.0	4.4	10.9	.7	41.5	13.3	75.2	75.9	57.3	150.0	207.3	3.1
1922	...	...	.9	4.0	9.8	.9	28.3	11.6	99.5	66.0	56.4	148.1	204.6	3.2
1923	...	...	1.0	3.6	9.8	.7	13.4	11.7	88.5	68.7	56.8	124.1	180.9	3.2
1924	...	...	.9	4.1	9.4	.6	12.1	10.6	84.0	72.3	116.7	175.4	180.9	3.6
1925	...	...	.9	3.4	8.3	.9	10.1	9.7	78.7	79.0	58.8	112.3	171.1	3.7
1926	...	...	.9	3.9	7.9	.9	10.5	8.4	74.4	82.7	58.4	109.6	168.1	3.7
1927	...	...	.9	4.1	8.4	1.3	9.3	7.9	73.2	86.0	61.2	107.4	168.6	3.8
1928	...	...	.9	4.4	8.1	1.4	8.1	8.8	69.9	92.6	64.1	107.3	171.4	4.2
1929	...	...	.8	4.3	8.9	1.4	10.8	9.0	65.4	97.1	62.4	110.7	173.1	4.8
1930	...	...	.9	5.1	10.0	.8	8.8	7.9	69.1	97.7	65.4	109.6	175.0	4.0

TABLE 6.—SCOTTISH BANKS. SUMMARY OF MONTHLY AVERAGES EXPRESSED AS AN INDEX NUMBER WITH 1924 AS BASE=100.

1919	...	...	209.6	17.7	40.0	39.2	162.5	34.0	46.4	37.1	48.9	50.8	50.2	67.4
1920	...	...	100.7	52.0	90.7	114.1	172.6	110.8	69.4	85.5	82.8	88.9	86.9	89.0
1921	...	...	108.2	107.5	115.9	131.3	343.5	125.4	89.6	105.0	97.7	128.5	118.2	87.5
1922	...	...	100.1	96.6	104.7	168.4	234.6	109.4	118.5	91.2	96.2	126.9	116.6	89.0
1923	...	...	109.0	88.1	104.8	123.5	111.2	110.1	105.4	95.0	96.9	106.3	103.2	88.5
1924	...	...	100	100	100	100	100	100	100	100	100	100	100	100
1925	...	...	94.7	83.1	88.1	170.0	84.0	91.1	93.7	109.2	100.2	96.2	97.5	103.2
1926	...	...	96.5	93.8	84.3	179.0	86.6	78.7	88.7	114.3	99.6	93.9	95.8	103.6
1927	...	...	91.7	99.1	88.9	243.9	77.2	74.1	87.2	119.0	104.4	92.0	96.1	106.7
1928	...	...	92.9	106.4	85.9	261.8	66.8	82.5	83.3	128.1	109.4	91.9	97.8	116.6
1929	...	...	88.7	103.8	94.8	249.9	89.0	84.3	77.9	134.3	106.4	94.8	98.7	134.5
1930	...	...	90.8	124.8	106.9	151.5	72.9	74.5	82.4	135.1	111.6	93.9	99.8	113.6

TABLE 7.

LONDON CLEARING BANKS.—TOTAL VALUE OF CHEQUES DRAWN ON CUSTOMERS' ACCOUNTS IN EACH MONTH FROM JANUARY, 1930, TO APRIL, 1931.

1930.						£
January	...	...	...	...	...	5,832,924,000
February	...	...	...	...	...	5,168,888,000
March	...	...	...	...	...	6,066,258,000
April	...	...	...	...	...	5,303,596,000
May	...	...	...	...	...	5,632,165,000
June	...	...	...	...	...	5,128,810,000
July	...	...	...	...	...	5,900,348,000
August	...	...	...	...	...	4,786,693,000
September	...	...	...	...	...	4,964,796,000
October	...	...	...	...	...	5,886,745,000
November	...	...	...	...	...	5,147,086,000
December	...	...	...	...	...	5,022,658,000
1931.						
January	...	...	...	...	...	5,772,131,000
February	...	...	...	...	...	4,843,038,000
March	...	...	...	...	...	4,983,308,000
April	...	...	...	...	...	4,953,996,000

Note.—These figures relate to the ten London Clearing Banks but they do not cover (a) branches of those banks situated outside England and Wales and (b) non-clearing banks affiliated to or owned by a Clearing Bank. For the calculation the Banks have taken the totals of the debit entries to current accounts (deposit accounts being excluded) as shown in their books without allowance for items which are not strictly cheques or bills (e.g., transfers from one account to another).

TABLE 8.

LONDON CLEARING BANKS AND SCOTTISH BANKS. CLASSIFICATION OF ADVANCES ON VARIOUS DATES FROM 22ND OCTOBER, 1929, TO 19TH MARCH, 1930.

	London	Scottish
	Clearing Banks.	Banks.
	£	£
1. Textiles (cotton, wool, silk, linen, jute) ...	81,632,371	4,977,214
2. Heavy industries (iron, steel, engineering and shipbuilding).	62,962,675	7,658,164
3. Agriculture and fishing ...	68,630,471	7,623,448
4. Mining and quarrying (including coal) ...	30,003,440	2,382,899
5. Food, drink and tobacco ...	63,177,889	5,967,176
6. Leather, rubber and chemicals ...	21,969,950	1,507,903
7. Shipping and transport (including railways) ...	25,176,565	3,487,859
8. Building trades ...	47,824,549	1,578,970
9. Miscellaneous trades (including retail trades) ...	146,496,288	9,009,182
10. Local government authorities and public utility companies (excluding railways)	52,384,672	6,676,757
11. Amusements, clubs, churches, charities, &c. ...	26,502,720	770,399
12. Financial (including banks and discount houses, stock exchange and building societies).	142,547,506	24,989,966
13. Other advances ...	218,402,248	28,550,094
	<u>£987,711,344</u>	<u>£105,179,031</u>

TABLE 9.
LONDON CLEARING BANKS AND BANK OF ENGLAND. DEPOSITS AND STERLING BILLS HELD, AND (CLEARING BANKS ONLY)
ACCEPTANCES OUTSTANDING ON ACCOUNT OF FOREIGN CUSTOMERS.
(£000 throughout).

	1927.		1928.		1929.		1930.		1931.		
	June 30th.	Dec. 31st.	June 30th.	Dec. 31st.	June 30th.	Dec. 31st.	June 30th.	Dec. 31st.	Jan. 31st.	Feb. 28th.	Mar. 31st.
<i>Deposits held on account of—</i>											
Banks with head offices abroad...	80,624	68,109	83,604	82,977	69,335	70,594	123,220	122,026	109,762	110,858	106,804
Foreign Governments ...	16,983	19,897	19,531	25,534	26,493	19,307	13,600	11,133	11,039	10,316	9,174
Other foreign customers...	20,998	21,978	22,149	22,990	23,274	21,530	25,000	21,118	21,475	20,129	20,333
Total Deposits ...	118,605	109,985	125,184	131,501	119,102	111,431	161,720	154,277	142,276	141,303	135,311
<i>Sterling Bills held on account of—</i>											
Banks with head offices abroad...	111,205	133,352	134,169	172,267	160,356	163,238	122,684	118,918	112,768	113,863	108,660
Foreign Governments ...	13,121	22,923	19,955	13,790	19,276	28,293	17,159	16,817	16,305	18,420	19,521
Other foreign customers...	4,216	5,150	4,107	8,471	9,608	9,923	7,862	8,740	7,088	7,952	8,482
Total Sterling Bills ...	128,542	161,455	158,231	194,528	189,240	199,454	147,605	144,475	136,161	140,235	136,663
Total Deposits and Bills...	247,147	271,440	283,415	326,029	308,342	310,885	309,325	298,752	278,437	281,538	271,974
<i>Acceptances outstanding on account of—</i>											
Banks with head offices abroad...	27,693	27,084	34,787	46,994	46,158	34,823	39,690	31,557	30,828	30,369	28,770
Foreign Governments ...	338	838	—	250	462	626	100	50	75	113	100
Other foreign customers...	3,086	3,290	3,124	3,180	3,614	3,744	2,630	3,219	3,150	3,319	2,727
Total Acceptances ...	31,117	31,218	37,911	60,424	60,234	39,193	42,420	34,826	34,053	33,801	31,597

Note—"Other foreign customers" includes Companies with head offices abroad.

TABLE 10.
SCOTTISH BANKS.* DEPOSITS AND STERLING BILLS HELD, AND ACCEPTANCES OUTSTANDING, ON ACCOUNT OF FOREIGN CUSTOMERS.
(£000 throughout.)

	1927.		1928.		1929.		1930.		1931.		
	June 30th.	Dec. 31st.	June 30th.	Dec. 31st.	June 30th.	Dec. 31st.	June 30th.	Dec. 31st.	Jan. 31st.	Feb. 28th.	Mar. 31st.
<i>Deposits held on account of—</i>											
Banks with head offices abroad	2,256	4,462	4,060	5,025	4,626	4,234	6,815	7,648	7,875	7,696	8,192
Foreign Governments ...	18	19	20	20	21	21	63	2	1	—	—
Other foreign customers ...	2,366	2,350	2,784	2,885	2,717	2,604	2,802	2,682	2,575	2,568	2,661
Total Deposits ...	4,640	6,831	6,864	7,930	7,264	6,859	9,680	10,332	10,451	10,264	10,853
<i>Sterling Bills held on account of—</i>											
Banks with head offices abroad	440	159	231	762	753	733	195	203	191	160	142
Other foreign customers ...	14	5	7	23	6	39	22	47	9	8	9
Total Sterling Bills ...	454	164	238	785	759	772	217	250	200	168	151
Total Deposits and Bills	5,094	6,995	7,102	8,715	8,023	7,631	9,897	10,582	10,651	10,432	11,004
<i>Acceptances outstanding on account of—</i>											
Banks with head offices abroad ...	196	171	410	491	544	285	297	255	225	209	215
Other foreign customers ...	132	289	146	363	837	500	448	586	621	458	489
Total Acceptances ...	328	460	556	854	1,381	785	745	841	746	667	704

* The figures relate to six banks only.

APPENDIX II.
BANK OF ENGLAND WEEKLY ACCOUNT, JAN., 1925, TO MAY, 1931.
 [Monthly Averages of Wednesday Figures in £ millions]

	ISSUE DEPARTMENT.						BANKING DEPARTMENT.					
	Notes in Circulation.	Notes in Banking Department.	Government Debt and other Government Securities.	Other Securities.	Silver Coin.	Gold Coin Bullion.	Public Deposits.	Other Deposits. Bankers' Accounts.	Government Securities.	Discounts and Advances.	Other Securities.	Reserve of Notes and Coin.
1925 Jan.	383.7	20.7	19.7*		7.0	123.7	17.5	70.0	50.5	17.1	57.8	22.6
Feb.	378.8	21.7	"		7.0	124.8	12.6	74.0	49.8	14.7	59.5	23.5
Mar.	360.3	22.2	"		7.0	126.8	13.2	69.6	40.6	15.3	60.9	24.0
Apr.	365.9	25.3	"		7.0	132.3	18.0	65.4	39.1	16.7	60.9	27.1
May	384.5	26.8	"		7.0	153.4	15.0	73.5	35.8	12.8	60.9	29.8
June	385.2	28.0	"		7.0	155.3	11.9	75.5	40.1	12.5	61.2	29.8
July	387.0	34.4	"		7.0	159.3	14.4	77.5	38.7	14.6	60.6	36.2
Aug.	387.2	36.9	"		7.0	162.2	16.3	68.0	34.3	9.7	60.6	38.7
Sept.	380.4	36.1	"		7.0	159.4	17.5	70.4	37.9	10.7	62.4	36.9
Oct.	378.5	29.0	"		7.0	152.4	9.7	64.8	31.3	11.8	59.6	30.8
Nov.	376.0	24.3	"		7.0	143.1	14.2	67.5	39.1	15.8	59.2	26.1
Dec.	361.4	18.6	"		7.0	142.6	18.9	70.6	64.9	22.9	57.9	20.4
1926 Jan.	373.7	20.4	"		7.0	143.2	17.6	68.4	45.6	21.4	58.6	23.2
Feb.	369.3	21.6	"		6.7	144.7	20.0	63.1	39.2	19.9	61.9	28.0
Mar.	373.6	22.7	"		6.6	143.2	17.8	64.6	42.2	15.8	57.2	24.1
Apr.	375.6	23.9	"		6.6	145.1	13.9	68.8	43.4	12.4	58.6	25.3
May	385.0	25.6	"		6.6	147.2	19.3	78.1	44.7	17.2	58.6	27.1
June	379.3	27.4	"		6.6	148.4	12.9	89.3	38.0	21.5	56.3	26.7
July	377.9	28.1	"		6.6	150.1	10.8	71.8	38.0	16.2	57.6	29.4
Aug.	376.8	31.2	"		6.6	152.6	15.0	68.2	36.0	13.9	56.3	32.5
Sept.	371.9	33.8	"		6.5	154.2	18.3	65.7	34.2	13.8	56.6	35.3
Oct.	371.2	32.6	"		6.3	151.2	18.3	66.6	36.3	14.9	56.6	33.9
Nov.	368.7	32.3	"		6.3	152.2	20.5	62.9	34.8	14.6	56.6	31.7
Dec.	374.8	30.4	"		6.3	150.9	10.6	70.7	34.6	19.4	58.1	33.9
1927 Jan.	365.4	31.9	"		6.3	150.2	13.2	78.2	32.7	22.3	69.8	33.2
Feb.	361.7	31.9	"		6.3	149.1	14.9	88.6	29.6	12.4	61.5	33.2
Mar.	365.5	31.5	"		6.0	149.2	19.1	64.3	31.9	13.9	61.8	33.2
Apr.	376.8	33.7	"		5.7	151.5	17.6	64.4	36.0	14.4	51.4	35.3
May	373.6	35.7	"		5.7	152.2	15.2	62.6	47.5	18.2	28.6	37.4
June	378.2	33.4	"		5.7	150.6	14.9	68.4	50.9	20.0	32.0	35.0
July	375.3	31.8	"		5.7	149.9	12.9	67.5	49.1	18.8	32.3	33.4
Aug.	377.9	32.8	"		5.7	150.4	15.7	64.9	52.7	14.7	32.4	34.6
Sept.	374.2	33.0	"		5.7	149.6	20.1	63.1	53.4	11.0	35.8	34.9
Oct.	373.5	33.5	"		5.7	149.6	21.6	64.2	49.8	14.2	40.7	34.9
Nov.	373.5	33.5	"		5.7	149.6	18.8	61.0	41.9	13.9	42.0	35.0
Dec.	379.5	31.4	"		5.7	149.5	12.8	78.4	46.1	16.9	46.4	32.5

1928	Jan.	371.5	57.9	163.0	10.1	75.9	37.0	39.9	23.6	44.7	36.7
	Feb.	365.0	5.4	157.5	19.6	61.2	36.9	33.9	8.3	45.2	42.1
	Mar.	367.4	5.6	157.3	17.6	63.7	37.3	33.9	8.3	45.2	42.8
	Apr.	373.2	5.5	157.0	10.8	68.7	37.5	32.2	11.0	47.4	42.9
	May	371.7	5.4	160.3	16.8	63.0	36.5	29.5	8.6	46.8	46.3
	June	376.2	5.4	168.5	18.0	63.8	36.9	29.3	10.3	44.1	53.3
	July	376.2	5.4	172.2	16.0	65.0	36.5	28.2	17.0	40.2	58.3
	Aug.	375.7	5.4	171.5	14.8	65.0	36.5	28.2	9.0	37.0	58.3
	Sept.	372.8	5.4	173.0	14.8	65.0	37.0	28.2	9.0	38.2	60.8
	Oct.	370.1	5.4	164.0	21.0	62.8	36.4	28.2	11.1	37.0	62.6
	Nov.	369.3	5.3	161.4	17.4	61.9	37.0	27.4	11.1	26.4	50.4
	Dec.	379.7	5.2	155.9	10.1	68.8	38.8	62.0	15.9	19.0	36.7
1929	Jan.	383.9	5.1	153.5	16.0	67.6	37.2	62.1	16.2	19.0	36.7
	Feb.	363.6	5.6	143.2	14.3	62.4	36.8	49.1	9.2	16.9	49.8
	Mar.	366.4	5.6	152.2	14.8	62.0	37.1	42.0	9.1	16.0	67.0
	Apr.	360.4	5.4	155.2	14.8	63.0	36.4	51.0	12.1	17.0	66.3
	May	361.9	5.8	160.8	13.7	69.8	36.4	40.3	9.4	16.9	66.3
	June	361.7	5.4	161.9	16.8	63.8	36.4	38.3	11.2	18.4	59.6
	July	368.9	4.2	160.9	14.4	65.0	36.9	47.3	20.3	22.6	61.3
	Aug.	369.1	4.8	150.9	14.4	65.0	36.4	73.0	8.0	23.0	43.2
	Sept.	363.6	4.8	138.2	17.5	61.4	36.4	73.0	8.0	24.3	30.4
	Oct.	360.7	4.8	130.9	11.4	63.8	37.7	73.2	6.9	20.9	32.7
	Nov.	356.6	4.8	122.5	14.5	58.8	36.3	63.6	6.9	20.9	31.4
	Dec.	369.4	4.7	139.3	8.9	63.9	36.3	63.9	12.8	19.1	30.2
1930	Jan.	355.8	4.5	149.3	19.6	75.6	36.0	41.0	15.7	15.2	58.7
	Feb.	347.3	4.5	151.0	16.8	55.8	36.0	40.6	6.7	14.4	64.3
	Mar.	349.7	4.5	153.0	12.1	56.9	36.1	40.6	7.7	15.1	64.1
	Apr.	359.8	4.5	160.4	17.8	65.2	36.5	57.1	6.7	10.9	64.1
	May	356.4	4.5	160.4	18.8	65.2	36.4	57.1	6.7	11.4	64.1
	June	360.4	4.5	168.4	13.8	60.0	36.0	50.0	6.7	11.4	66.9
	July	366.0	4.5	168.4	10.1	63.0	36.7	52.4	11.2	20.9	66.9
	Aug.	365.8	4.5	153.7	15.1	70.3	36.7	52.4	11.2	20.9	66.9
	Sept.	369.5	4.5	155.7	9.6	68.0	34.2	43.4	6.9	23.5	49.0
	Oct.	357.2	4.5	157.9	19.2	61.0	34.5	43.2	6.2	21.8	57.3
	Nov.	354.2	4.5	158.4	18.3	67.8	34.5	35.0	4.3	23.0	65.4
	Dec.	368.9	4.4	156.6	7.4	81.4	34.2	65.0	15.6	22.9	62.0
1931	Jan.	351.7	4.4	143.0	19.3	64.4	33.2	48.9	10.6	23.4	52.0
	Feb.	347.1	4.4	140.5	18.7	60.1	33.2	48.9	9.3	24.7	54.1
	Mar.	348.3	4.3	141.9	9.1	60.3	33.2	36.1	6.9	28.1	53.4
	Apr.	353.7	4.1	145.6	13.4	66.6	33.9	32.0	11.5	26.9	62.8
	May	353.9	4.1	140.4	12.2	68.0	34.3	33.3	6.2	26.3	56.5

† Including Currency Notes in Circulation prior to amalgamation of the Note Issues on 22nd November, 1928.
 * These are the figures of the "Government Debt", and the "Other Securities", as shown in the Bank Return prior to 22nd November, 1928.
 † For the months prior to the amalgamation of the Note Issues on the 22nd November, 1928, the Bankers' Deposits are compiled on a slightly different basis from that adopted since that date. Comparability for statistical purposes is, however, scarcely affected.

APPENDIX III.

ESTIMATE OF FUTURE MONETARY DEMAND FOR GOLD IF NO ECONOMY IN ITS USE IS MADE.
 (REPRODUCED FROM THE FIRST INTERIM REPORT OF THE GOLD DELEGATION OF THE FINANCIAL COMMITTEE OF THE LEAGUE OF NATIONS)
 (CONVERTED TO £ STERLING.)

(£ millions.)

Year.	Estimated gold production.	Non-monetary demand.	Available for monetary purposes.	Increments to gold reserves required to provide			Excess or deficit of amount of new monetary gold available compared with increment required to provide				
				33 per cent. cover for average increases in notes and sight liabilities of :	40 per cent. cover for average increases in notes and sight liabilities of :	33 per cent cover if notes and sight liabilities increase at :	40 per cent cover if notes and sight liabilities increase at :	2 per cent. per annum.	3 per cent. per annum.	3 per cent. per annum.	2 per cent. per annum.
1930	83.0	37.0	46.0	34.3	52.0	41.1	62.3	+11.7	-6.0	+4.9	-16.3
1931	82.6	37.4	45.2	34.9	53.4	41.9	64.3	+10.3	-8.2	+3.3	-19.1
1932	84.2	37.8	46.4	35.8	55.3	42.9	66.4	+10.6	-8.9	+3.5	-20.0
1933	83.6	38.2	45.4	36.6	56.7	43.8	68.2	+8.8	-11.3	+1.6	-22.8
1934	82.8	38.6	44.2	37.0	58.6	44.6	70.1	+7.2	-14.4	-0.4	-25.9
1935	81.8	39.1	42.7	37.8	60.4	45.4	72.3	+4.9	-17.7	-2.7	-29.6
1936	81.6	39.5	42.1	38.6	62.1	46.4	74.6	+3.5	-19.9	-4.3	-32.5
1937	80.5	39.8	40.7	39.5	63.9	47.3	76.6	+1.2	-23.2	-6.6	-35.9
1938	78.9	40.3	38.6	40.3	66.0	48.3	79.1	-1.7	-27.4	-9.7	-40.5
1939	76.0	40.7	35.3	41.1	67.8	49.3	81.4	-5.8	-32.5	-14.0	-46.1
1940	76.0	41.1	34.9	41.9	69.9	50.1	83.8	-7.0	-35.0	-15.2	-48.9

APPENDIX IV.

TABLE 1.—THE BALANCE OF PAYMENTS OF THE UNITED KINGDOM ON INCOME ACCOUNT: 1924 TO 1930.
(£ millions.)

	1924.	1925.	1926.	1927.	1928.	1929.	1930.
Excess of Imports of Merchandise and Bullion ...	324	384	475	390	358	366	392
Government Receipts from Overseas (net) ...	25*	77*	4	1	15	24	21
Net National Shipping Income ...	140	124	120	140	130	130	105
Net Income from Overseas Investments ...	220	260	285	285	270	270	235
Net Receipts from Short Interest and Commissions ...	60	60	60	63	65	65	65
Net Receipts from Other Sources ...	15	15	15	15	15	15	15
Total...	410	438	484	504	495	504	431
Estimated total credit balance on above items ...	86	54	9	114	137	138	39

* Excess of Payments made Overseas.

TABLE 2.—NEW OVERSEAS ISSUES ON THE LONDON MARKET.†
(£ millions.)

British Empire ...	73	68	52	88	86	54	70
Foreign ...	61	30	60	51	57	40	39
Total...	134	88	112	139	143	94	109

† Midland Bank figures.

TABLE 3.—THE BALANCE OF PAYMENTS OF THE UNITED STATES: 1924 TO 1929.
(In \$ millions: Export Surplus (+) and Import Surplus (-)).

Class of Transactions.*	1924.	1925.	1926.	1927.	1928.	1929 (unrevised).
Excess of Exports of Commodities over Imports	+ 882	+ 633	+ 278	+ 583	+ 850	+ 734
<i>Miscellaneous Invisibile Items.</i>						
Freights (net)	- 64	- 84	- 95	- 68	- 80	- 115
Tourist expenditures (net), including ocean-borne passenger traffic.	- 373	- 410	- 406	- 444	- 562	- 565
Interest on American private funds abroad	+ 635	+ 689	+ 740	+ 800	+ 893	+ 976
Interest on foreign funds in United States	- 192	- 229	- 268	- 281	- 359	- 414
War Debt receipts (interest and principal)	+ 183	+ 186	+ 195	+ 206	+ 207	+ 207
Other Government transactions (net)	- 53	- 61	- 49	- 29	- 57	- 92
Immigrant remittances (net)	- 229	- 235	- 218	- 206	- 225	- 223
Miscellaneous (net)	+ 13	+ 24	+ 28	+ 25	- 27	- 24
Total, commodity and miscellaneous (net)	+ 802	+ 513	+ 205	+ 588	+ 650	+ 484
Gold shipped or earmarked†	- 236	+ 72	- 72	+ 154	+ 272	- 120

* This classification is not directly comparable with that in the table for the United Kingdom.

† Including Paper Currency in 1924 and 1925.

TABLE 4.—DATA RELATING TO NET INCREASE IN EXTERNAL INVESTMENT AND FOREIGN CAPITAL ISSUES IN THE UNITED STATES.

Difference between American long-term investment abroad and foreign investment in the United States (net).	- 733	- 560	- 540	- 695	- 708	- 386
Change in net debt of American banks to foreigners	+ 216	- 61	+ 359	...	- 226	+ 13
Net Capital Movement (long and short term)	- 517	- 621	- 181	- 695	- 934	- 373
Foreign Capital Issues publicly offered (excluding re-funding issues).	960	1,076	1, 25	1,337	1,251	671

APPENDIX V.
 INDICES OF WHOLESALE PRICES IN VARIOUS COUNTRIES FOR EACH MONTH IN 1929 AND 1930.
 (1913=100 in all cases).

	United States.		Canada.		France.*		Germany.		Italy.*		Netherlands.		Japan.	
	1929.	1930.	1929.	1930.	1929.	1930.	1929.	1930.	1929.	1930.	1929.	1930.	1929.	1930.
January	139.3	133.8	147.7	149.4	128.0	114.4	138.9	132.3	125.8	113.9	146	131	172.2	152.2
February	138.5	131.9	149.5	146.9	129.6	114.6	139.3	129.3	126.2	111.3	146	126	171.0	151.0
March	139.7	130.1	150.2	143.6	129.9	112.2	139.6	128.4	125.8	109.0	147	122	171.0	148.1
• April	138.7	129.9	147.0	143.3	127.3	111.3	137.1	126.7	124.1	108.9	144	122	170.2	145.7
May	137.2	127.7	144.4	140.5	126.5	109.9	135.5	125.7	123.2	106.5	142	118	168.6	143.1
June	138.1	124.4	144.7	137.5	124.0	108.1	135.1	124.5	121.8	104.1	141	118	167.6	137.0
July	140.4	120.3	150.0	134.1	124.5	109.2	137.8	125.1	119.9	102.3	141	115	166.0	133.4
August	140.0	120.3	153.3	131.4	121.1	108.0	138.1	124.7	119.3	103.5	142	114	165.1	132.7
September	139.7	120.6	152.0	128.9	121.3	106.4	138.1	122.8	119.2	102.2	141	112	164.4	129.6
October	138.0	118.3	151.1	127.2	119.6	103.2	137.2	120.2	118.9	99.4	140	111	163.4	124.4
November	135.2	115.2	149.7	124.7	118.5	100.2	135.5	120.1	117.5	98.4	137	110	159.6	122.6
December	135.0	112.3	150.3	121.6	116.9	99.0	134.3	117.8	115.8	95.4	135	107	164.9	121.5

* In terms of present currency.

APPENDIX VI.

STATISTICS PREPARED BY THE STAFF OF THE ECONOMIC ADVISORY COUNCIL.

TABLE I.

EXPORTS AS A PERCENTAGE OF PRODUCTION.

The following table shows the diminishing importance of the export trade relatively to our whole national economy. Distinction is drawn between workers in manufacture and workers in all occupations (the latter includes building retail trade and so forth).

	Workers Manufacturing for Export as a Percentage of all Manufacturing Workers.	Workers for Export as a Percentage of the Whole Occupational Total + Population ^{employed by the unemployment}
1907	44.5	...
1924	39.4	29.6
1929	38.4	27.4
1930 (2nd quarter) ...	33.8	23.5

The following table gives the figures on which Table I is based :—
(Figures in thousands.)

	Workers Employed by Export Trades.		Total Engaged in Mining and Manufacture.	Total Engaged in Building, Distribution Services, &c.
	(i) Manufacture.	(ii) Transport and Distribution.		
1907	2,465	300	5,550	3,700 approx.
1924	2,485	325	6,315	3,200
1929	2,445	350	6,375	3,815
1930 (2nd quarter)...	2,000	285	5,905	3,915

TABLE 2.

REAL WAGE AND PRODUCTIVITY CHANGES SINCE 1924.

The following table examines in detail the factors relating to the rise in real wages since 1924. It will be seen that, on the whole, physical volume of output per head has risen faster than real wages, which have been held back by the fact that retail prices have fallen more slowly than wholesale. There has been some rise in the ratio of wage-costs to proceeds. The figures in the table refer to manufacture and mining.

Sources: *Board of Trade Index of Production.*

Employment estimated by method given in Journal, Royal Statistical Society, 1929, Part I.

Real wages from Professor Bowley's Index and Ministry of Labour Cost of Living Index.

Selling value of manufactured goods from average values of British exports.

Money value of net output from above index of selling prices and Sauerbeck index for raw materials, assuming 30 per cent. of selling value represented by raw materials in 1924 (*Vide* Flux, A.W., "The National Income" in Journal, Royal Statistical Society, Vol. 92, Part I, 1929).

Year.	Persons Employed (000's).			Output Index.			Output per head.			Real Wages.	Index of Selling Value Manufactured Goods.	Index of Margin between Manufactured Goods and Raw Materials.	Money Value of Net Output per Man.	Money Wages.
	Manu- facture.	Mining.	Distri- bution, Trans- port, Building Services.	Manu- facture.	Mining.	General.	Manu- facture.	Mining.	General.					
1924...	5,220	1,093	3,229	100	100	100	100	100	100	100	100	100	100	100
1927...	5,470	840	3,693	109.3	95.0	106.8	104.3	123.8	106.8	86.5	86.0	91.7	100.7	100.7
1928...	5,463	771	3,767	109.4	89.2	105.5	104.5	126.4	106.8	86.3	86.8	92.6	99.7	99.7
1929...	5,547	829	3,815	115.1	96.8	111.8	108.2	126.3	110.7	84.0	86.8	96.1	99.1	99.1
1930... (1st quarter)	5,316	861	3,835	113.2	102.0	110.9	111.2	131.3	113.2	82.0	86.0	97.5	98.7	98.7
1930... (2nd quarter)	5,145	758	3,845	107.5	87.4	103.4	109.3	126.1	110.4	80.5	85.8	95.8	98.3	98.3

TABLE 3

EMPLOYMENT, OUTPUT PER HEAD, ETC., IN MAIN INDUSTRIAL GROUPS, 1924-1929.

The following table examines in further detail the rise in productivity per head since 1924. Current value of net output is calculated for each group of industries on the assumption that net output is proportional to gross output.

Sources: *Board of Trade Index of Production*. Employment calculated from annual figures published by Ministry of Labour. Output per head from above two. Selling prices from average value of exports (except for coal and iron and steel where Board of Trade price indexes are used directly).

	Volume of Employment. (Thousands.)					Physical Volume of Output. 1924 = 100.					Output per Worker. 1924 = 100.					
	1924.	1927.	1928.	1929.	1924.	1927.	1928.	1929.	1924.	1927.	1928.	1929.	1924.	1927.	1928.	1929.
	Coal mining	1,093	840	771	829	100.0	94.0	89.0	96.4	100.0	122.4	126.2	127.1	100.0	122.4	126.2	127.1
Iron and steel	246.0	235.8	227.5	231.5	100.0	110.0	102.3	114.0	100.0	114.3	110.2	120.6	100.0	114.3	110.2	120.6
Engineering and shipbuilding (including motors and electrical trades).	1,158	1,118	1,206	1,243	100.0	115.2	113.1	120.9	100.0	112.2	115.7	115.6	100.0	112.2	115.7	115.6
Textiles	1,088	1,155	1,138	1,130	100.0	101.6	99.9	98.5	100.0	94.7	95.5	94.8	100.0	94.7	95.5	94.8
Food, drink and tobacco	476.6	497.5	496.3	498.3	100.0	99.7	101.9	106.0	100.0	95.5	97.8	101.4	100.0	95.5	97.8	101.4
Leather and boots	179.1	180.8	165.6	165.0	100.0	107.7	102.0	98.5	100.0	106.7	110.4	106.9	100.0	106.7	110.4	106.9
Chemical and allied trades.	183.8	192.7	202.9	205.3	100.0	105.2	110.3	112.5	100.0	100.4	99.9	100.8	100.0	100.4	99.9	100.8
All industry	6,324	6,338	6,242	6,359	100.0	106.8	105.5	111.6	100.0	106.6	106.9	111.1	100.0	106.6	106.9	111.1

	Index of Selling Prices, 1924 = 100.				Output per Worker. (£ per annum at Current Prices.)				Annual Earnings. (Average per Worker.)	
	1924.	1927.	1928.	1929.	1924.	1927.	1928.	1929.	1924.	1928.
	Coal mining	100.0	86.1	75.5	90.0	175	185	171	186	123	97
Iron and steel	100.0	84.3	78.7	77.5	228	219	197	211	153.1	151.1
Engineering and shipbuilding (including motors and electrical trades.)	100.0	96.0	96.1	94.1	214	231	238	232	131.3	136.5
Textiles	100.0	79.5	84.4	81.7	178	136	144	138	84.7	84.8
Food, drink and tobacco	100.0	86.8	88.9	81.9	371	308	323	308	105.3	105.5
Leather and boots	100.0	99.8	117.2	109.4	190	200	245	222	115.7	111.7
Chemicals and allied trades.	100.0	89.8	85.0	82.1	380	342	321	314	131.5	136.5
All industry	100.0	87.2	86.7	85.0	218	204	203	206	120	117

TABLE 4.

EARNINGS AND PRODUCTIVITY IN CERTAIN INDUSTRIES, 1907-1924.

The following table is designed primarily to show for certain important industries the rise in *money* wages since pre-war days as compared with the *money* value of net output per head. The division of the proceeds of industry between wages and profits is thus shown directly without the necessity of calculating "real" wages and "physical" productivity per head.

Sources: *Census of Production Preliminary Reports*. Earnings and Hours Enquiries, 1907, 1924, 1928. Selling prices index calculated from Census of Production Reports.

	Net output per Person Employed (£ per Annum).		Average Annual Earnings (£ per Annum).		Average Weekly Hours.		Earnings as Per Cent. of Net Output.		Selling Prices (1907=100).
	1907.	1924.	1906.	1924.	1906.	1924.	1906-7.	1924.	
Coal	127	175	86	123	8	7	68	70	211
Iron and steel	115	218	82	155	54.5	44.8	71	71	158
Engineering	109	189	68	123	53.0	47.0	62	62	—
Shipbuilding	98	164	71	131	52.9	47.0	73	80	137
Motor and cycle	109	226	68	144	53.4	47.0	62	69	90
Cotton	79	159	48	93	55.5	47.9	61	58	251
Wool	71	187	40	102	55.6	48.0	56	55	280
Silk and artificial silk	55	255	34	99	64.6	48.0	62	39	—
Hosiery	61	159	39	88	33.9	47.6	64	65	258
Textile finishing	109	251	55	126	55.7	48.0	51	50	268
Clothing	62	151	35	70	51.7	46.2	56	46	256
Boot and shoe	71	170	47	115	53.6	47.8	66	68	179

Grain milling	...	...	...	...	...	178	341	61	139	138	58.1	46.7	34	41	158
Baking ...	...	...	...	...	...	104	254	54	119	116	55.5	48.6	52	47	167
Brewing...	...	...	...	...	...	325	685	63	136	135	54.9	47.9	19	20	213
Tobacco...	...	...	...	...	...	155	617	35	108	116	49.6	47.1	23	18	296
Brick ...	...	...	...	...	...	78	209	56	126	126	55.4	48.5	72	60	—
Pottery ...	...	...	...	...	...	68	156	48	98	97	52.5	46.9	71	63	—
Chemicals	...	...	...	...	...	183	369	63	134	139	54.7	48.1	34	36	178
Rubber ...	...	...	...	...	...	124	247	52	112	114	55.0	47.7	42	45	—
Printing...	...	...	...	...	...	108	294	59	161	164	51.5	47.3	55	51	—
Furniture	...	...	...	...	...	85	196	63	129	133	53.1	46.7	74	66	—
Laundry	...	...	...	...	...	55	136	33	78	—	54.0	47.0	60	58	—
Building	...	...	...	...	...	84	205	68	147	147	53.2	45.3	81	72	—
Gas ...	...	...	...	...	...	205	272	78	152	158	52.6	48.5	38	56	—
Water ...	...	...	...	...	...	411	508	70	146	149	55.1	47.5	17	29	—
Electricity	...	...	...	...	...	249	472	74	163	170	51.9	47.3	30	34	—
All industry (manufacture and mining)	...	...	...	...	...	100	220	52	120	117	54	47.1	52	55	103
											approx.				

TABLE 5.

PHYSICAL VOLUME OF OUTPUT PER HEAD, 1907 AND 1924.

The following table gives the results of a calculation designed to secure some measure of changes in the net output of industry expressed in an unchanging money standard. The materials of industry and the final produce of industry are obtained free of duplication and correctors applied to the 1924 figures in accordance with the rise in prices of raw materials and finished goods respectively. By subtraction, the "real" net output is obtained.

	Value 1907. (£ million.)	Value 1924. (£ million.)	Prices 1924. (1907=100.)	1924 at 1907 Values.
Final product	1,139	2,478	190	1,304
Materials	464	848	175	484
Net output	675	1,630	—	820

This shows a rise of 21½ per cent. of "real" aggregate net output as against a rise of 10½ per cent. in the number of workers between 1907 and 1924. *But there are no statistical data as to the increase of capital which has assisted in bringing this about and which needs to be remunerated out of the product.*

Sources: Reports of Census of Production 1907 and 1924. Value of raw materials in 1924 from *Flux loc. cit.* Prices of finished goods calculated from average values in Census of Production.

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