

**LABOUR'S WAY TO CONTROL
BANKING AND FINANCE**

LABOUR SHOWS THE WAY

THE WILL AND THE WAY TO SOCIALISM

By Clement R. Attlee, M.P.

LABOUR'S WAY TO PROVIDE WORK AND LEISURE

By Walter Citrine, General Secretary of the Trades Union Congress.

LABOUR'S WAY TO HEALTH AND HAPPINESS

By the Rt. Hon. Arthur Greenwood, M.P.

LABOUR'S WAY TO PLAN PROSPERITY

By David R. Grenfell, M.P.

LABOUR'S WAY TO PEACE

By the Rt. Hon. Arthur Henderson, M.P.

LABOUR'S WAY WITH THE COMMONWEALTH

By the Rt. Hon. George Lansbury, M.P.

LABOUR'S WAY TO USE THE LAND

By Tom Williams, M.P.

LABOUR'S WAY TO CONTROL FINANCE

By John Wilmot, M.P.



**LABOUR
SHOWS THE WAY**

General Editor : Clement R. Attlee, M.P.

**LABOUR'S WAY
TO CONTROL BANKING
AND FINANCE**

by

JOHN WILMOT, M.P.

1935



METHUEN & CO. LTD. LONDON

First published in 1935

PRINTED IN GREAT BRITAIN

FOREWORD

IN this little book I have tried to show what is wrong with our present financial arrangements and what I think a Labour Government would do to improve them.

As this is a matter which affects the lives of all of us I have tried to avoid technical terms and to write in language which everybody can understand. I am indebted to several City friends for their help, but the opinions expressed are my own.

J. W.

CONTENTS

CHAPTER

PAGE

I. WHAT IS WRONG 1

Poverty amid plenty—The present depression the latest of a series—The crisis of abundance—Wealth destroyed while people want—The tragic triangle—The way out—New money system needed—Producers are consumers—The function of finance—The proper use of savings.

II. BANK OF ENGLAND AND THE GOLD STANDARD 20

Public ownership of the Bank of England—Wide support for the proposal—Bank of England still a private institution—Its public functions—The Government bank—The bankers' bank—Divergence of interests of bank and public—The gold standard—Its failure in modern conditions—Distribution blocked—Only moneylenders benefit by gold standard—Effects of fall in prices—Money should be related to goods, not gold—The bank rate—The volume of credit—Financial diplomacy.

viii **BANKING AND FINANCE**

CHAPTER

PAGE

III. THE JOINT STOCK BANKS 50

The functions of the joint stock banks—How the banks create credit—The Macmillan Report—Credit a vital public service—How to avoid political management—A National Banking Corporation—Excessive speculative financing—Small firms—Distressed areas—Safety of deposits.

IV. THE MONEY MARKET 70

What the money market is—Its part in the 1931 crisis—How to prevent a repetition—Temporary finance for British industry.

V. CAPITAL AND INVESTMENT 78

Importance of new capital market—How the market works at present—The Stock Exchange—Brokers and jobbers—Permission to deal—‘Bulls’ and ‘bears’—How banks help speculation—The waste of capital—How a boom begins—And slump inevitably follows—The vicious spiral—Signs of a new boom—Foreign lending—Evils of unsound foreign loans—The National Investment Board.

VI. TO SUM UP 112

CHAPTER I

WHAT IS WRONG

Poverty amid plenty—The present depression the latest of a series—The crisis of abundance—Wealth destroyed while people want—The tragic triangle—The way out—New money system needed—Producers are consumers—The function of finance—The proper use of savings.

THE tragic events of recent years have made it clear that there is something radically wrong with our existing economic and financial system.

The whole purpose of any such system ought to be to arrange that the largest possible quantity of goods and services is produced, distributed and consumed, so that the standard of life of the people shall be maintained at the highest level which our productive capacity can provide.

Yet, although we are richer than we have ever been, for it is now possible to produce

enough to supply everybody with all that is needed for a comfortable life, poverty, unemployment and insecurity curse the lives of the majority of our people. They are forced to go without the things they need, not because of any scarcity, but because the system of private capitalism upon which we rely for the proper exchange and distribution of our products has broken down.

It has often been said that this system of private capitalism, despite its obvious defects and manifest injustices, had the great virtue that it worked. It no longer works. It is breaking down, not only in this country, but in America and all over Europe; appalling poverty, widespread unemployment, ruin and bankruptcy are the results of its failure.

Not only has it failed to provide the worker and producer with an adequate recompense for his labour, but it is guilty of preventing millions of capable producers from working and earning at all. It has failed so completely in its task of securing a reasonable distribution of wealth that vast quantities of goods which people need are being allowed to rot or are being

artificially destroyed, and means are devised to prevent the production of the wealth that man's work and organization, ingenuity and inventive cunning have made it possible to obtain in ever-increasing quantity.

It has succeeded only in bringing about individual poverty in the midst of plenty.

Nor can it be claimed by its defenders that the present depression is due to causes which are not related to the present private capitalist system. This crisis is not a unique occurrence for which there is no precedent. It is the latest and most serious crisis in a long succession of crises.

In the course of economic and industrial history for the last 140 years there have been eighteen major economic crises and a number of minor ones, indicating clearly that we are not to-day suffering simply from the consequences of an economic blizzard for which no one is responsible, but from one of those periodic depressions which are characteristic of the operations of a system which leaves major decisions of economic policy to private enterprise under the inspiration of the profit motive.

But, although there have been many crises

before, the present depression does undoubtedly differ from those which have preceded it in important respects, as pneumonia differs from a bad chill.

Moreover, the depression has come at a time when we might well have expected a steady and consistent improvement in social conditions and in the standard of life of the peoples of the world as a result of our enormously increased powers of production.

It is thus the particular paradox of this crisis that it is a crisis, not of want, but of plenty.

Famine or the failure of harvests have played no part in it. Drought and crop disease indeed are, ironically enough, being hailed to-day, not as the enemies but as the saviours of mankind.

Our trouble is not that we have insufficient to go round but that we do not know how to distribute the plenty which we possess. As a result we are faced with a situation which must affront the intelligence and the conscience of any man, no matter to what political party he may belong, or indeed if he takes no interest in politics at all.

At a time when millions of people are hungry, there is an enormous unsold surplus of grain and of other goods which the world possesses but which are not being distributed. Children lack clothes, but in the great producing countries cotton is being ploughed back into the land because it cannot be sold. In Brazil coffee is being burned, in Malaya and the Dutch East Indies rubber planters have learned to regard as a blessing a pest which destroys their trees. Our fishermen are forced to cast back their catch into the sea and our farmers to restrict the produce of their soil.

The leaders of industry and commerce are using their ability and experience, not to promote production, nor to devise methods of distributing the material wealth which industry can create, but for promoting plans for the restriction of output. In tin, and rubber, in wheat, in sugar, and in tea, in one after another of the great commodity-producing industries, international schemes of restriction have been drawn up.

We may well ask, when we survey the world to-day, whether some special kind of

lunacy has not overtaken the human race, that it has come to regard destruction as the object of commercial diplomacy and he who destroys most as the greatest benefactor of mankind.

We are, indeed, faced with a sort of triangle of ironic tragedy—unemployed men and women, unemployed money, unemployed raw materials. Private capitalism is demonstrably incapable of doing anything to end this intolerable situation, for the fault does not lie with any particular section. Neither producers, distributors nor consumers can be blamed for the disasters which have overtaken them, nor under the present system can we convict bankers, financiers or investors ; while each is forced to pursue its own sectional interest none can remedy the real trouble which is the system itself.

The producer must seek to make a profit by producing, without in any way being able to ensure that those who need his goods will be able to buy them. There is no effort made to see that sufficient purchasing power is available among the mass of the population, so that increasing consumption shall balance increasing production. It is

nobody's business to see that the savings of the nation are protected and used for the orderly development of national prosperity, and there is no authority to check the wild gambling in stocks and shares and commodities which plunder the small investor and bring disaster to the nation.

There has been, it is true, some slight improvement from the worst depths of the present depression. As international trade has collapsed there has been some temporary development in home markets which has done something to mitigate the worst horrors of economic chaos.

But even the most sanguine do not imagine that this movement, which is indeed already showing signs of slowing down, can do anything to provide a permanent solution of the problem of unemployment and of poverty in the midst of plenty.

Are we then to resign ourselves to our lot, to exist as best we may on a lower standard of living even than that known prior to the depression? Are we merely to hope for a gradual return to better times and for a new boom which will certainly be followed by another slump? Or are we

to set to work deliberately and intelligently to plan our economic life so as to ensure a steadily improving standard of life as our productive efficiency increases, and to establish a stable and assured economic system in place of the present chaos ?

The Labour Party believes that the greater part of the British people will support with enthusiasm and determination an effort to replace this chaos by a proper planning of production and distribution if they can once be shown that it can be done.

The primary fact of the economic position to-day is that the old fear of shortage is over. The problem is not how to produce but how to distribute what is produced. Yet that problem can never be solved while the profit motive and the speculation in commodities and shares which are inherent in the capitalist structure and the capitalist philosophy make a disastrous succession of booms and slumps inevitable. Under private capitalism there cannot be any successful plan of production and distribution for the general good. A two-fold problem faces those who desire to replace the present muddle with a carefully planned economic and financial machine which will

do its work without friction and continual breakdown, and which will allow the human race to get on with the higher business of living, freed from the perpetual economic worries of the day.

It is necessary to create a new monetary system which will ensure that as productive capacity increases the ability to consume the goods produced shall also increase, and it is necessary thoroughly to reorganize the existing financial and industrial system and remove its patent abuses.

The economic crisis is due not to lack of supply but to lack of buying. The rock upon which the system of private enterprise has foundered is the problem of making effective the huge demand for food and clothes and manufactured articles of all kinds which modern industrial civilization can produce in such abundance. We can to-day obtain chemicals from the air to fertilize our fields and increase our food crops many times over. We can produce cheaply hundreds of articles of all kinds, where formerly it was possible to produce only a few at very great cost. And we can do all this with much less effort. We have invented electric shovels which can handle

as much work in an eight-hour day as would once have taken the labour of 4,800 men ; we have brick-making machines which will make 3,200 bricks in eight hours, whereas it used to take one man the same time to make 450 bricks.

In every industry to-day machines have taken over work which once demanded the labour of many men, yet instead of taking advantage of these twin discoveries—how to increase production, and how at the same time save human toil and energy, in order to improve our standard of living and increase our leisure—we have been content to let our products lie unused and to allow labour saving to result in unemployment instead of increased leisure. In the ship-building industry half the workers are without jobs. One out of every three coal-miners is unemployed ; in cotton and wool and iron and steel it is one out of every four ; in the jute industry two out of every three ; in public works contracting two out of every five ; in shipping and docks two out of every seven and in the boot and shoe industry one out of every five of the workers can find no work to do.

It is an intolerable situation and it raises

at once that important question of the need for a much wider distribution of wealth and of purchasing power, not only for reasons of social justice, but on economic grounds also. It is upon these grounds that the Socialist demand for reorganization of the financial, industrial and economic situation is based.

Industrial concerns of the past, with their small output and relatively expensive production, could continue quite satisfactorily provided that there was a comparatively small number of people who had sufficient money to buy the goods produced. But as industry and the great agricultural and commodity-producing enterprises turn more and more in the direction of large-scale production, and the use of huge plants which must produce in the mass if they are to be economic, so clearly the circle of consumers must also increase if the new type of industrial machinery is to find a market for its output.

One clear and obvious example will illustrate this. Whereas the motor manufacturer of the past could carry on his business successfully so long as there were a small number of wealthy people who

could buy his highly priced product, the motor manufacturer of to-day whose factory is turning out cars by the hundred in an almost endless stream must look, not to the few, but to the demand of an ever-increasing number of purchasers.

It has become essential, therefore, if the modern industrial system is to survive, that there should be, not simply a few people with large incomes, but a large number of people with reasonably good incomes.

That is no longer a matter of what is socially desirable; it has become a matter also of economic necessity. But how are we to provide this increased purchasing ability on the part of the majority which the industrial system demands on economic grounds, just as the social conscience demands it on human grounds?

To see how that increased purchasing power is to be made possible—and if it is not made possible, then there is no permanent solution to the tragic problem of poverty and plenty, of the bankruptcy of farmers, producers, and manufacturers, and of Governments in consequence of economic depression—we have to look at the financial system from an entirely new angle. We

must cease to be confused by the intricacies of currency transactions and of all the paraphernalia of the money market, and we must judge our monetary and financial system as we would judge any other institution—by results. We must free ourselves from that feeling of awe which always assails us when faced with a complex mechanism and say to ourselves in effect : ‘ Well, it all looks very wonderful, but does it fulfil its functions ? Does it accomplish what it promises ? ’

Now the main function of finance is to facilitate the distribution of goods and services. It must in the first place provide the man who has produced something or given service with some kind of money with which he can obtain those goods and those services which he requires for himself. Money fundamentally has no real importance beyond the fact that it is a token of value and a medium of exchange which does away with the necessity of direct barter.

Barter is not practical in a complex modern community. There would, for instance, be an impossible confusion if every one who wanted groceries, clothes,

tobacco, vegetables and so on, had first to go to a grocer and offer to work for an hour in return for a supply of groceries, then to the tailor and offer to help him for so many hours in return for a suit of clothes, and then to all the other shops with the same sort of offer to them. In the highly industrialized modern world every person is in one way or another a specialist, doing a certain kind of work, but in order to live each person requires the products of many other people's work.

It is essential, therefore, that there should be some token of value which can be received for goods produced and services performed, and then exchanged as desired for goods and services needed. And it must be a token which will be accepted by everybody, so that those who take it from us in return for what we need can in their turn exchange it for something they require.

One-pound and ten-shilling notes, the silver and the copper we carry about with us are these tokens, and it is desirable to remember that the real function of money is that of a token which will facilitate the exchange of goods and services. We are

sometimes rather apt to forget that most important fact and to give it another value. If money is a token which makes exchange of goods and services possible, it is, consequently, the link which connects production with consumption.

It must be remembered that we are all both producers and consumers, even though the production of some of us, clerical workers, transport workers or administrators, may not be something concrete which can be handled. Nevertheless, we all play our part in production, and as individuals we are all consumers of other men's products. It is, therefore, of the utmost importance to all of us that the channel between production and consumption should never become clogged, for if it is we may find ourselves thrown out of work as producers because there is a glut on the market, while at the same time, as consumers, we find it impossible to obtain enough of the things we need because we have not sufficient money to buy them.

Now clearly this task of linking up production and consumption is one of the main duties of the financial system. But it has also a second very important function

—that of organizing, administrating and directing the investment of savings.

Saving is essential under any system, whether it be capitalist or Socialist.

Saving represents the willingness to forgo immediate pleasure for future well-being, and upon it civilization is based ; it was not until the cave-man recognized the necessity for storing up some of his present wealth of goods, skins, or fuel, for the future that the first beginnings of stable community life became possible.

In an industrialized community it is obviously essential that some thought should be given to the necessity for replacing machinery as it wears out, and for buying and storing raw materials which can later be made into finished manufactured goods. That is to say, the whole of the value of the products of any industry must not immediately be consumed. A factory manufacturing shoes cannot, for example, simply distribute the whole of the money it receives for the sale of its shoes amongst its workers, shareholders, officials and directors. It must recognize that in course of time it will be necessary to replace its existing machinery by newer machinery,

that there is the cost of the upkeep of the factory to be taken into consideration and charges of one kind and another, and it must, therefore, if it is to be wisely run, build up reserves out of the value of present production in order to undertake the capital expenditure which will be necessary to continue that production in the future.

Similarly the community as a whole must distribute its wealth among what are commonly termed consumption goods and capital goods. Instead of spending the national income entirely on things immediately consumable, we must put something aside for the purchase of capital goods—that is, of new plant, new factories, new ploughs, new reaping machines, new units of production of all kinds. The money spent on these capital goods will find its way into consumption through the money distributed in wages, dividends, salaries and so on by the manufacturers of capital goods. But the producers of capital goods must, in their turn, make a certain saving out of current income to cover cost of replacement of plant, or factory extensions in the future. The cost of experiment,

invention and improvements must be provided.

Under our present system of private enterprise saving is largely a haphazard business left to the private individual, and particularly to the person who has a larger income than he can possibly spend on his ordinary daily requirements, and who is, therefore, in a position to put a substantial proportion of that income to investment.

This private investment of capital forms so important a part of the capitalist system that one would have thought that the financial institutions which are the centre of that system would have taken particular care to ensure that the business of investment was administered in a responsible manner, so that there was always sufficient money available for sound capital developments, and those who saved money for investment were not discouraged by periodic heavy losses.

The maintenance of an adequate supply of money to ensure that production and consumption keep pace with each other, and the direction of the flow of savings into capital industries, are indeed of vital importance to the maintenance of the

industrial system. Yet no care is taken to see that they are performed efficiently, as we will see when we come to examine the existing financial structure and the effects and defects of its operations.

CHAPTER II

BANK OF ENGLAND AND THE GOLD STANDARD

Public ownership of the Bank of England—Wide support for the proposal—Bank of England still a private institution—Its public functions—The Government bank—The bankers' bank—Divergence of interests of bank and public—The gold standard—Its failure in modern conditions—Distribution blocked—Only moneylenders benefit by gold standard—Effects of fall in prices—Money should be related to goods, not gold—The bank rate—The volume of credit—Financial diplomacy.

THE Labour Party's proposals for national control of the Bank of England and the joint stock banks have already created a considerable amount of controversy.

Political opponents are endeavouring to create fears in the public mind that the

return of Labour to power will lead to a financial crisis. Those fears are quite unjustified, as a little calm consideration of the present operations and powers of the banks and of the case for their public control will show. Let us consider the Bank of England first, for the Bank of England is the centre of the present financial system and has powers and responsibilities which make its operation of direct importance, not only to every other financial institution, but to every industrialist and business man, and ultimately to every individual in the community.

Now the proposal that the Bank of England, as the central bank of the country, should be under national control is not by any means the startling and unique suggestion that opponents of the Labour Party's policy would have the general public believe.

On the contrary, it is the present lack of any public control of the Bank of England that is unique, for the Bank of England is the only important central bank in the world which is completely free from governmental control.

In France the central bank is controlled

by the State, in the United States the Federal Reserve Board system, which for geographical reasons takes the place of one central bank, has always been closely controlled by the Government, and that control has been substantially increased by President Roosevelt in his efforts to grapple with the breakdown in America. In Sweden, the central bank, the Riksbank, is controlled by a board of seven directors, one of whom, the chairman, is appointed by the King, and the other six are elected by the Swedish Parliament. In Italy, in Germany and in Russia the central banks have now, as one would expect, hardly any distinct existence, but are completely controlled by their respective Governments, while it is to be noted that among the new central banks which have recently been created, measures are being taken to ensure some governmental and parliamentary control.

Thus in the new central bank of New Zealand the Secretary of the Treasury is to be a member *ex officio* of the board, while three directors are to be appointed by the Governor General in Council. Moreover, the appointment of the governor and deputy governor of that bank is subject

to the approval of the Governor General in Council.

It will be seen from these facts that the suggestion that national control of the Bank of England would inevitably lead to a breakdown of confidence and a banking crisis, as is suggested by the Labour Party's opponents, is on the face of it absurd.

So far from this being a revolutionary proposal which is bound to lead to disaster, the Bank of England is, in the words of the famous Macmillan Committee on Finance and Industry, 'almost unique as a central bank; in fact, it is a private institution practically independent of any form of legal control.'

The present constitution and powers of the Bank of England, so far from being the result of deliberate consideration of what is to-day essential in the national interest, are a legacy from the past when the needs and conditions were quite different from those of the present time.

Its continued existence as an entirely private institution exercising the power which should be in the hands of the State, is indeed as anomalous as would be the

continued existence of a private army or private police force.

The Bank of England should perform a vital public service and, apart from all other considerations, it is essential that it should be brought into line with other public services and with the practice of other important countries. Its position to-day is indeed a very remarkable one. Although as the central bank of this country it holds the reserves of the joint stock banks, undertakes Government financing, and determines national credit policy, it is still a purely private institution which has experienced no important amendments of its constitution since it was established in 1694.

It has an issued capital of £14,553,000, and its stock is held by investors in the ordinary way, the total number of stockholders being now about 14,500.

But these stockholders have no voice whatever in the policy of the bank, so that even the limited form of democracy inherent in the joint stock company system does not exist here. The policy of the bank is decided solely by the Governor in conjunction with the Court of Directors; this Court of Directors, who elect the

Governor and Deputy Governor, is a purely self-appointed body. It does not even include among its members any representative of the great joint stock banks and hardly any industrial or commercial leaders, although recently one or two men concerned in industry, such as Sir Josiah Stamp, Chairman of the L.M.S. Railway, and Sir Basil Blackett, formerly Chairman of Imperial and International Communications, have been appointed to the Board. Those with any practical knowledge of industrial and trading interests are, however, in a very small minority on the Board, and in the main its directors are still, as in the past, international merchant bankers, some of whose firms, such as Baring Brothers and J. Henry Schroder & Co., seem to have a sort of hereditary right to a seat on the Board.

New directors are co-opted by the existing Court and are largely the personal choice of the Governor, who thus exercises an autocracy quite out of keeping with modern democratic ideas and which is contrary to the whole political tradition of this country. It is indeed much as though the heads of great State departments like

the Treasury, the Admiralty, the War Office, the Board of Trade, the Ministry of Health and the Board of Education were appointed in perpetuity solely by the decision of a small group of people in a London club, and as though once appointed they had complete power to invite whomsoever they pleased to assist them in the administration of those departments, with no responsibility whatever to give any account of their stewardship to Parliament or to the public.

The total number of the directors of the Bank of England is twenty-six, including the Governor and Deputy Governor, but there is an inner cabinet of nine members, including the Governor and Deputy Governor, which is known as the Court of Treasury, and which in practice is responsible for all major decisions of policy.

This Court of Treasury is elected by secret ballot from among the general body of directors, and the names of its members are never published, a system quite medieval in its form.

Moreover, the Bank of England is not even subject to the ordinary controls which

govern the affairs of companies concerned in matters of no vast public importance. It publishes no proper balance sheets, and issues no annual reports.

What are the powers and responsibilities handed over by the nation to this self-appointed committee of City bankers? They can be split up into three main divisions, each of vital importance to the nation.

The Bank of England is first the banker of the Government. It is responsible for handling for the Government its public long-term loans, for the issue of short-term Government loans such as Treasury bills which run for three months, and for making advances to the Government if and when they are needed, just as an ordinary bank makes advances to its customers. Moreover, it has recently acquired a side line by becoming the financial adviser of big public corporations, such as the Central Electricity Board, which it advises on the issuing of capital. This aspect of its responsibility is likely to increase if, as is probable, there is a development of these large public utility corporations formed under State supervision.

In addition the bank is the Government banker, and as such, issues supplies to the various spending departments ; it also runs many accounts in connexion with the national debt and taxation.

Secondly, it is the banker of the joint stock banks, holding a large proportion of their cash reserve, just as they, in their turn, hold the cash of their customers who deposit money with them ; though unlike them it does not pay any interest on money on deposit. Like the joint stock banks, it is prepared to lend money on bills to approved clients, the rate at which it is prepared to lend being what is known as the bank rate, which is fixed at a meeting of directors held every Thursday morning.

But in addition to these banking duties, the Bank of England has a vitally important third function, for it is responsible for the management of the currency note issue. It now has, in fact, the sole right to issue currency notes in England, although certain banks in Scotland and Northern Ireland still have that privilege which, however, is a curtailed and nominal privilege in that their notes must be backed by currency notes issued by the Bank of England.

In the matter of issuing notes the bank acts as the agent of the Government, to which the entire net profits of the issuing department go, and the amount of notes it issues is governed firstly by the amount of gold held, and secondly by the legal limit of what is termed the fiduciary issue. The fiduciary issue means currency notes which are not backed by gold, but by Government securities, and the amount of the fiduciary issue is limited to £260,000,000 without the specific assent of the Treasury which can agree to a further increase, as it did, in fact, when we left the gold standard.

Such facts as these make a rather dull recital, and one which the ordinary person may think has little connexion with his own affairs. But actually they are extremely important because they mean in effect that the Bank of England very largely governs the financial and credit policy of the country. It controls, in fact, the issue of those tokens which make the exchange of goods and services possible, and provide the link between production and consumption, to which reference was made in the previous chapter. It determines in effect how much money is in circulation.

It is for this reason that it is so important to remember that the Bank of England is dominated by international merchant bankers.

There is no suggestion that these merchant bankers are in any way corrupt in their relationship with the Bank of England, or that they make improper use of their positions for their own private benefit.

But as international bankers their interests and their experience are sharply divorced from those of the majority of the population. And those interests and that experience inevitably colour their banking policy.

To the producer of goods and to the consumer of goods, money is a token which facilitates trade, but to the international banker it is the actual commodity in which he deals, and he is concerned, therefore, not with the function of money as a token, but with its function as a profit-earning instrument.

The international banker is concerned primarily with lending money abroad at a profit. From that arises a very important conflict of interest between the international

lender of money and the producer and consumer of goods.

To both the producer and consumer what is important is the value of money in terms of goods. But to the dealer in money what is important is that if he lends money abroad he shall be able to get back the same amount of actual money tokens irrespective of whether those tokens are worth more or less in terms of goods.

And here we come to the important question of the gold standard. The gold-standard system was designed by bankers for serving the interests of bankers and, although in its working it affected the life and prosperity of everybody, the general public was completely apathetic about it until the financial and political crisis of 1931 put it on the front page of the newspapers.

The Bank of England for its own purposes desires, and is pledged to, a return to the gold standard. The Labour Party is opposed to the gold standard, and is pledged to its replacement by a currency system related to the level of prices; in this the Labour Party is supported by many leading industrialists and economists.

What is the reason for this conflict of opinion between the present rulers of the Bank of England and the Labour Party on this important matter of currency policy, and which system is best for the ordinary person ?

Under the gold standard currency is kept stable not in terms of goods, but in terms of gold.

In brief, the theory underlying the gold standard is that if two units have a fixed relation to a common denominator, they have a fixed relation to each other.

If the English pound is worth a fixed quantity of gold, and the French franc is also worth a fixed quantity of gold, then the pound will always be worth the same number of francs.

Under the gold standard, to keep the pound worth a fixed quantity of gold, the Bank of England has to undertake to exchange any note for gold on demand, and, therefore, it is clear that the total amount of the currency notes of a country on the gold standard has to depend upon the amount of gold held by the central bank.

And if the amount of gold held by the

central bank declines, then the amount of currency has also to be reduced so that the fixed relationship with gold shall be maintained.

It follows, therefore, that the gold standard can only operate if those countries which have what is termed a favourable balance of payments, that is, whose income from abroad exceeds their expenditure abroad, agree either to take their excess of income over expenditure not in gold, but in goods, thus increasing their imports from abroad, or to lend their surplus abroad.

For if they take it in gold they will draw gold away from other countries, and so force their central banks, which are losing gold, drastically to reduce the currency in circulation or finally, if the drain continues, to abandon the gold standard.

In the old days, when the gold standard system was working, Great Britain was the pre-eminent industrial country. While for the majority of the population it was a time of bitter poverty, sweated labour, and slums even more dreadful than those which remain to-day, the vast profits which came to the great capitalists from the export

trade enabled them not only to extend their own plants, but, through the banks, to lend enormous sums abroad. With the development of industry in other countries and the abandonment of general free trade the conditions necessary for the functioning of the gold-standard system have gone. The Labour Party, which is essentially realist in its outlook on these problems, appreciates this fact, which the bankers, befogged by tradition and self-interest, apparently do not.

But over and above this, there is another serious defect in the gold-standard system—a defect which would check economic progress even if all the other conditions were favourable, and if all the creditor countries of to-day were prepared to follow the same international lending and free-trade policy followed by Britain before the war.

If the amount of currency in the world is to be restricted according to the supply of gold in the world, it is clear that the amount of money can only be increased at the same pace as the amount of gold increases. But as the supply of gold does not, and cannot, increase sufficiently fast to

keep pace with productive enterprises in modern conditions, the supply of money for facilitating the exchange of goods and services is bound to be restricted, and the exchange and distribution of commodities and manufactured goods will become blocked.

It was, in fact, blocked again and again in the past when the gold standard, according to its supporters, was supposed to be working satisfactorily.

On several occasions economic depressions were brought about by the failure of purchasing power to keep pace with productive output, and were only ended by the discovery of new gold-mines or of new processes of speeding up gold production, which brought about an expansion of currency, and thus allowed purchasing power to catch up once more with production.

If depressions occurred from that cause in the past, how much more likely are they to occur in the future in view of the enormous developments in the science of mass production during recent years.

The vast improvement in the technique of industry, the application of science to

crop production, the great increase in the use of machinery, all have enormously increased our powers of production and consequently made possible a much wider distribution of material wealth than ever before. Under modern conditions such a wide distribution of material wealth is not only possible, it is, in fact, economically essential. Mass production, if it is to be successful, must be balanced by mass consumption.

If the modern industrial and economic system is to work, there must be a much greater effective consuming power than in the past, in order to balance a much greater effective producing power, and it must be much more widely distributed. But effective consuming power is only possible if there are sufficient money counters to allow production and consumption to balance.

That is impossible under the gold standard, because under that system the supply of money is related to the production, not of the general mass of commodities, but of one industrially unimportant metal—gold.

The gold standard suits the international

bankers and the international lenders of money because it means that the money they lend will always have a fixed value in terms of gold which is, under the gold standard, in its turn readily exchangeable at a fixed rate into any currency they desire.

It suits the dealers in money in another way. If, owing to the stabilizing of currency in terms of gold, the amount of currency is restricted while production of commodities and manufactured articles is increasing, then a unit of currency is given an increasing value in terms of commodities and other products. In other words, their own particular commodity—money—is given a scarcity value in terms of other commodities. That means, of course, that those who deal in money, or who lend money at fixed interest, are enriched, because the real value of the money in which they deal, or the incomes they receive from their investments, is increased.

But it has a very damaging effect upon everybody else. If the value of money is increased in terms of goods, then the price of goods falls. The producer has to be prepared to give more of his produce in

exchange for £1, or a franc, or a dollar, or any other unit of currency, than formerly.

At a superficial glance this process, which is usually called a fall in prices, though it could be more accurately described as a rise in the value of money, may seem to be a good thing. It may appear that, as a result, we are all able to buy more with the money we possess, and consequently improve our standard of living.

But although a fall in the price of individual commodities or manufactured products due to improved technical efficiency in manufacture may be beneficial, a general fall in the whole level of prices owing to a shortage of money has very evil results, because we are all—except the fortunate few who are able to live solely on invested incomes—producers as well as consumers.

And as the value of the things we produce declines the money we receive for our production falls, and our consuming power is consequently reduced.

It will, for instance, be clear that if, as happened during the present depression, the prices of raw materials and commodities fall, the purchasing power of the raw-

material and commodity-producing countries falls likewise. They may produce as much, or more, than formerly, but they receive less money—fewer counters—in exchange for what they have produced. Consequently in their other capacity as consumers they have less money to spend.

Moreover, as the prices of raw materials fall, the great industrial users, who are the chief purchasers of these raw materials, restrict their buying for fear that if prices decline further they will be in the position of holding stocks on a falling market and thus involve themselves in a heavy loss.

Therefore each fall in price makes sales more difficult, and leads to a further fall.

Now the raw-material producers are very largely customers of the manufacturers, and as their incomes decline so they are forced to reduce their buying of manufactured goods. The manufacturer, faced with a declining market, is accordingly forced to reduce his output, close down some of his works, and to economize all round. More people are thrown out of work, and their purchasing power, in its turn, also declines; hence unemployment leads to fresh unemployment and to a widening depression.

But although this is clearly bad for the vast majority of people in the world in their capacity both as producers and as consumers, there is one section which it benefits, the lenders of money who have contracted to lend money in return for a fixed rate of interest.

It benefits them, because, however much the income of the borrower may decline through a fall in the value of his products, he must still pay to his creditors the same amount of interest. But the payment of that interest absorbs a much larger proportion of his total income than formerly. In other words the larger share of the total amount available for producers, for wages, social services, industrial profits and the like, has to go to the holder of fixed interest security. The lender receives the same amount in money as formerly, but the real value of that money in terms of goods and of services has increased. He has been enriched at the expense of the rest of the community because the money in which he deals has been given a scarcity value in terms of goods.

The Labour Party believes, therefore, that, as the gold-standard system is unsound

under modern conditions of increased productive output, it should be changed. It believes that it should be replaced by a system which will relate money to productive power instead of to gold—a system which in other words will ensure that as our ability to produce increases, the amount of money available shall likewise be increased in order that effective consuming power may keep pace with effective producing power.

It proposes to do this by relating the supply of money to the producing and consuming capacity of the nation by means of an index of the average price of commodities and raw materials, instead of to the supply of gold in the Bank of England. We can obtain a rough, but on the whole fairly accurate, guide to the relation of production to consumption by the demand for raw materials.

If the price of such raw materials as a whole falls, it is clear that industrial demand is lagging. Now the demand of the industrialist for raw materials is governed by his ability to sell his finished articles. Therefore, if he is not buying raw materials, it is clear that it is because he is unable to

sell his finished products. But we know that in a world in which so many people are living very much below a reasonable standard of life, the real need for industrial products as a whole and for foodstuffs is not satisfied.

The decline in demand is due, not to a lack of real need, but to a lack of effective demand, in other words to a lack of ability to buy owing to an insufficient supply of money. Under the index system, therefore, the average price of a very large number of raw materials and of primary foodstuffs is taken as a guide. If, for instance, the average price were to fall by 5 per cent, that is the index number fall from 100 to 95, it would be clear that consumption was lagging behind production. And that in its turn would be an indication that general purchasing power should be increased by an increase in the amount of money in use. That this can be done in practice is demonstrated by the experience of Sweden, where the central bank is under public control. By the operation of a monetary policy on the lines indicated above a remarkable economic stability has been maintained throughout the depression

and in spite of the serious repercussions of the Kreuger scandal, with the result that the credit standing of Sweden is among the highest in the world. It is clear, of course, that by monetary policy alone, measures can only be taken to increase the general volume of buying power, and not to ensure that buying power is properly distributed.

That would be a task of a Labour Government through higher wages, planned control of industry, and a greater distribution of national wealth which does not come strictly within the confines of currency policy, but is dealt with by other writers in this series.

What is essential, however, is that currency policy should assist rather than obstruct the task of distributing the material plenty which is now within our power to produce.

The belief that such a reorganization of our currency system is essential both on economic grounds, and on grounds of social justice, is one of the reasons for the demand by the Labour Party for a national control of the Bank of England. Thus monetary policy may be removed from the control of a group of bankers, and become

the concern of the Government, appointed by the people to take decisions on all matters of national policy, among which that of currency policy is certainly not the least important.

But in addition to its present control of currency policy the Bank of England has other important responsibilities which clearly ought, as an examination will show, to be outside the realm of private enterprise. None is more important than the question of the rate of interest.

It is the bank rate which in normal times determines the rates at which money is lent. The rate at which the bank is prepared to lend money is fixed each week, and as the City institutions which borrow money from the banks to carry on their financial business wish to re-lend it at a profit, the bank rate affects interest rates generally. For example, the rate charged by the joint stock banks on overdrafts is usually fixed at 1 per cent above the bank rate figure, with a minimum of 5 per cent.

Movements of the bank rate, therefore, directly affect the whole commercial and industrial life of the country because, under modern conditions, a large proportion of

commercial transactions are financed on borrowed money.

The close relationship between charges for bank advances and wages, for instance, is shown by some interesting calculations made some time ago by Mr. E. A. Radice, then general secretary of the New Fabian Research Bureau. Dealing with the necessity for a reduction in bank charges, similar to the reduction which has taken place in war loan interest under the conversion scheme, he pointed out that the advances for the ten clearing banks during 1932 amounted to £843,000,000, and that a $1\frac{1}{2}$ per cent reduction in the interest charged on these, that is, the same as the reduction in war loan interest, would have saved industry and commerce £13,273,000 a year and that, according to the Ministry of Labour's figures, the estimated decrease in wages in 1932 was £248,250 a week or taken over fifty-two weeks £13,389,000 a year. The closeness of these two figures suggests, that if the banking charges to industry at that time had been reduced, a large proportion of the wage cuts would have been unnecessary.

Moreover, the Bank of England, by its policy, can not only affect the rate charged by the banks and other suppliers of short-term loans, but also control the total amount of credit available.

The joint stock banks, as will be explained later, are governed in their supply of credit, that is in the granting of overdrafts and loans, by the actual amount of cash they hold. Experience has shown them that in order to meet normal cash withdrawals by their customers, they must hold cash to an amount of one-tenth of their total deposits; the total deposits depend on the amount of loans, since a loan to one customer soon becomes part of the deposit of another.

Now the Bank of England, by the purchase and sale of Government securities (which are termed open market operations) can increase or reduce the supply of cash which the banks hold.

If it sells Government securities it can reduce the supply of cash, but if it buys Government securities it can increase the supply of cash. How this happens is clear, for if the bank sells Government securities and, instead of allowing the money it receives from those securities to go into

circulation again, holds it in its reserves, it has in fact withdrawn money from circulation. If on the other hand it buys Government securities, it has given out currency for securities and that currency will, in the normal course of things, eventually be paid into the banks by those who sold the securities.

Since the banks' cash is about a tenth of their deposits, a reduction in the amount of cash held by the joint stock banks means that, if they have previously been lending up to their limit, they must reduce their total deposits by *ten times the amount* of the reduction of their cash resources, and that the only way they can reduce those deposits is by restricting loans. Therefore these operations by the Bank of England can have a very important effect indeed upon the ability of industry and commerce to obtain money for development.

Such major decisions of policy should, we submit, not be left to a private corporation, which might conceivably be engaged in contracting credit for its own purposes, just at a period when the Government of the day regarded it as essential in the national interest that there should be an

expansion of credit in order to increase prosperity and to finance new developments.

Moreover, it has to be remembered that, in the modern world, finance is playing an increasingly important part in international diplomacy. By credits to Continental countries, the Bank of England has since the war frequently played a more important part in foreign policy than the Foreign Office itself; it is an open secret that while British foreign policy, under Sir Austen Chamberlain, was friendly with France, the Bank of England, under Mr. Montagu Norman, used its financial influence to pursue an entirely contrary policy. With the question of which policy was right, and which was wrong, we are not here concerned. The principle is the important matter. And the principle at stake is whether a private institution should be allowed to wield a power which enables it to run directly contrary to the foreign policy decided upon by the Government of the day, and to use the influence which it possesses to undermine the influence of the elected Government.

The Bank of England, as at present constituted, follows a traditional policy of

never explaining or justifying its actions, and as a private institution it is not called to account, whatever the effects of its policies may be upon internal or world affairs.

It may make decisions ultimately of more importance to the well-being of the country and to its relation to foreign countries than those of the Cabinet itself, but unlike the Government, it cannot be questioned in Parliament and it is not called upon to answer to the electorate.

That is an impossible situation in a modern democratic country. The Bank of England has important public responsibilities and immense power, and it is essential that it should be answerable to the will of the people.

CHAPTER III

THE JOINT STOCK BANKS

The functions of the joint stock banks—How the banks create credit—The Macmillan Report—Credit a vital public service—How to avoid political management—A National Banking Corporation—Excessive speculative financing—Small firms—Distressed areas—Safety of deposits.

WHILE the Bank of England is the creator of credit, the great joint stock banks perform a no less important public service as the distributors of credit, and also, to a secondary extent, as credit creators in their own right.

It is already clear that the Labour Party's proposals for the national control of the joint stock banks, under a National Banking Corporation, are to be the subject of unscrupulous attack and misrepresentation. Suggestions—completely unfounded—that the national control of the joint stock banks

will mean the loss of the depositors' money are already being made. Such suggestions are entirely baseless, for so far from undermining the credit of the banks, and affecting the safety of the savings of depositors, the Labour Party's proposals would strengthen the banks' credit, and greatly improve the depositors' security.

The functions of the joint stock banks in the modern financial world are twofold. The banks are the custodians of money deposited with them on current or deposit accounts, and they are the main lenders of money for short periods to industry and commercial and other borrowers.

To their function as custodians of depositors' money there is no need to devote much explanation. It is a simple matter and one with which most people are acquainted, but it is necessary to explain that the popular impression, that the amount shown in the banks' accounts as deposits represents only the cash deposited with them by the public, is not correct. Neither is the belief that the banks re-lend only the cash deposited with them. In actual fact the banks build up a vast structure of credit which is many times the

amount of their actual cash deposits. This was made very clear in the report of the now famous Macmillan Committee on Finance and Industry, which was appointed by the Chancellor of the Exchequer in 1929. The Committee, which was composed of leading representatives of finance, commerce, trade and labour, pointed out (page 34) that in fact 'the bulk of the deposits arise out of the action of the banks themselves, for by granting loans, allowing money to be drawn on overdraft, or purchasing securities, a bank creates a credit in its books which is the equivalent of the deposit.'

This perhaps will be understood more easily if one pauses to think for a moment what happens when a bank grants a loan.

If, for instance, it grants a loan of £100, what happens is that it allows the borrower to have a loan account, and that amount is transferred to his current account, out of which he can draw, although he has not actually deposited money into the bank. And in the bank's books that transaction will appear as an advance, balanced on the outer side by a deposit.

For the purpose of this illustration it is convenient, as is done in the Macmillan Report, 'to assume that all banking is concentrated in one bank. Let us suppose that a customer has paid into the bank £1,000 in cash, and that the bank is able to judge from its experience that only the equivalent of 10 per cent of the bank's deposits need be held actually in cash to meet the demands of customers.'

Such an assumption on the part of the bank is perfectly correct, because it has to be remembered that most business transactions, and even a large percentage of personal transactions, are conducted, not by the actual payment of currency notes or coins, but by the drawing of cheques. If you pay your gas company, for instance, a cheque in settlement of the gas account, it is practically certain that instead of going with that cheque to the bank and drawing out an equivalent amount of cash, the company will simply pay the cheque into their own account, and then proceed to draw cheques in its turn for the payment of various debts. And it is again practically certain that the majority of cheques they pay out, instead of being cashed, will

be paid by their recipients into their banking accounts.

Thus actual cash, such as currency notes and coin, never enters into most transactions to-day. Cheque money, instead of notes or silver, provide the necessary counters.

It is therefore perfectly reasonable, as has been shown by experience, for a bank which has received £1,000 in cash to judge that it need only hold 10 per cent of it in cash.

And if this is so, then the £1,000 cash received will obviously support deposits amounting to £10,000, seeing that only 10 per cent of the total deposits is ever likely to be drawn upon in cash.

Supposing that the bank, after receiving the £1,000 cash, grants a loan of £900. It will open a credit of £900 for its customer, and when the customer draws a cheque or cheques for £900 from the credit so opened that cheque or cheques will—on the hypothesis that there is only one bank, and for practical purposes in this matter all the joint stock banks may actually be counted as one—be paid into the account of another of the bank's customers. To quote again from the Macmillan Report:

' 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 sum of £1,000 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 the 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.'

Although in this example it has been assumed for the sake of simplicity that there is only one bank, the process is the

same under actual conditions in which there are a number of banks. The credits granted by one bank may be drawn upon by its customer, and the cheques paid to the customer of another bank. What happens then is that there is established a claim by the second bank upon the first for cash, and the ability of the second bank to grant loans is increased to the same extent as that of the first bank is reduced. But over the banking system, as a whole, loans and investments made by the banks increase their deposits just as if there were only one bank, while in practice, of course, instead of settling each claim as it arises between one bank and another, there is a central clearing house at which all the various transactions are balanced, so that actually only a comparatively small transfer from one bank to another is necessary.

Now it is no part of the Labour Party's case for the public control of the banks that this system under which credits are created to nine times the actual amount of cash deposited is an improper or an unsound system.

It is neither. It is a perfectly legitimate and sensible system, and one, indeed, which

is essential if the modern financial and business machine is to function.

But this creation of a credit on the basis of cash is clearly a public service, rather than an enterprise for private profit. It is possible because of the character and habits of the British people and the tradition and business practice by which people are prepared to accept cheques instead of demanding actual cash. Ultimately all credit is based upon the national credit, and the Government is in practice forced to come to the aid of the banks in time of crisis, as we saw in 1914 and again in 1931.

The Times, in a remarkable leading article on the City page in its issue of January 21st, 1935, discussing the Labour Party proposal for the public ownership of the banks, admitted that 'if the power really exists to create money, or credit, by making entries in books, it seems hard to deny that it should be taken out of private hands and transferred to the State, to be used not for private benefit and profit, but for the profit and benefit of the community.'

That the banks do possess this power to create credit was conclusively proved by the

Macmillan Committee, to whose report we have already referred. In face of the authoritative testimony of this Committee, which included such acknowledged experts as Mr. Reginald McKenna, Lord Bradbury, Professor Gregory, and Mr. J. M. Keynes, it is of little use for *The Times* to argue, as it does later in the same article, that the prevalence of the idea that the banks create credit is an illusion. It is also of great public importance to consider another aspect of this creation of credit. From time to time large subscriptions to Government loans are made both by the banks themselves and by their customers with money borrowed from the banks. In so far as the credit thus placed at the disposal of the Government is, in fact, not the re-lending of depositors' savings, but is a transfer of created credit, it would appear to be undesirable that the public exchequer should have to bear the interest charges for the use of credit which has no basis in cash.

It will be realized that in consequence of this ability to create credit many times in excess of the cash actually deposited with them by their clients, the banks are the possessors of very great power.

It is true, as has been shown, that the Bank of England is the ultimate controller of the volume of credit, but upon the joint stock banks depends the decision whether to make full use of the ability to grant loans made possible by the policy of the Bank of England. It is theirs, also, to decide in what direction, and to what industries, the advances shall be made. The joint stock banks could, if they wished, effectually prevent an expansion of credit even though the Bank of England were following an expansionist policy. Moreover, it will be impossible for the State to lead the planning and revival of an industry if the banks are left free to wreck its plans by refusing to grant credit in the direction which is nationally desirable.

Clearly banking policy must be regarded, and treated, as a whole. If one agrees, as a large and ever-increasing number of people even outside the Labour Party do now agree, that the Bank of England, as the creator of credit, should be under national control, it is equally essential that the joint stock banks, as the distributors of credit, should be under national control. Otherwise the two parts of the banking system,

which for efficient operation must be in harmony, might be working in opposite directions.

There is at the present time an enormous redundancy of branches, and quite unnecessary and useless competition between the joint stock banks for ordinary banking business.

One frequently sees in one comparatively small centre several branch banks, where quite obviously one would be sufficient to transact all the business.

In consequence of this superfluity of branches, and the heavy overhead charges, the banks' charges on advances are undoubtedly higher than they need be. It is estimated that overhead charges account for 2 per cent on all loans, and, indeed, the banks themselves argue that they cannot afford to lend on advances at a rate below 5 per cent, however cheaply they borrow, because below that rate they would not be able to cover their costs.

There is also a quite unjustifiable number of directors. The Big Five joint stock banks have between them 165 directors, who receive in directors' fees a total of £309,000 per annum, or nearly £1,000 for

every working day. In addition there are large numbers of local directors, one of the joint stock banks having no fewer than ninety-six.

Many of these directors have no particular experience, and perform no useful function. They represent a dead-weight charge on the banking industry which cannot be justified, and which is quite unnecessary.

The Labour Party proposal is, therefore, that there should be formed a National Banking Corporation, under the direction of a small board appointed by the Government, on grounds of ability and experience. It would very probably include some of the chief officials of the existing joint stock banks, who are at present responsible for all decisions regarding day-to-day policy.

The board would co-operate with the Government in determining the general lines of banking policy, and would be required to work with the publicly owned Bank of England and with the National Investment Board, whose functions will be dealt with in a later section of this book. Subject to such co-operation on broad questions of national policy there would,

of course, be no political interference with the conduct, administration or detailed policy of the bank any more than there is at present with the Central Electricity Board.

There is no ground whatever for the suggestion that there would be direct Governmental control of advances to individual clients of the bank. The essentially confidential relationship between the bank and the individual customer would be maintained as strictly under a national banking system as it is to-day.

To give an example of what is meant by co-operation with the Government on the general lines of banking policy: If it were considered desirable in the national interests that there should be an expansion in an industry, it is clearly essential that the Government of the day should be able to ensure that such development will not be held up by the refusal of the banks to afford the necessary credit facilities to that industry.

It must also be in a position to overcome the difficulties created by the past policy of the joint stock banks, who in consequence of previous loans having become frozen,

have a large vested interest in many industries. The Lancashire cotton industry, where many mills are virtually in the possession of the banks as mortgagees, is a notable case in point. A national re-organization of such industries in the public interest might, therefore, be delayed or made impossible if the banks were left uncontrolled, and were able to use their position as creditors of these industries to insist upon preferential treatment, which might hamper the whole scheme of re-organization.

There is one other aspect of joint stock banking policy which is also of very considerable importance. The joint stock banks, while they are generally considered by the public as advancing money mainly to industry and commerce, are, in fact, often more concerned with advancing money for purely Stock Exchange purposes.

Exactly what proportion of the joint stock banks' business is accounted for by Stock Exchange transactions is not known, but some indication is given by the fact that out of a grand total of £35,484,157,000 cheques cleared through the Bankers' Clearing House in 1934, £30,740,117,000

were represented by what are known as town clearings, which in the main represent Stock Exchange and other purely financial business.

In a very large number of instances the purchase of Stock Exchange securities, and particularly purchases on speculative account, is financed by bank advances.

It is true to say that without the assistance of the banks, speculation on a large scale on the Stock Exchange would be impossible. This Stock Exchange business is favoured by the banks because when financing Stock Exchange business banks can obtain, as security for loans, easily negotiable stocks and shares, whereas when advancing money for business or industry, they must advance either on the character of the borrower, or on the security of plant and buildings, which cannot easily be sold if they consider it necessary to foreclose.

But while financing of Stock Exchange business is easier from the point of view of the banks, it is obviously not of so much national advantage as financing trade and industry.

It may indeed be definitely to the national disadvantage if such financing leads, as it

did, for instance, during 1928-29, to a boom on the Stock Exchange, which was quite unjustified by real economic and industrial conditions.

The Labour Party believes that speculation in Stock Exchange securities is definitely harmful and wasteful of the national wealth, and it is part of its policy to control and check that speculation.

National control of the joint stock banks would provide the power to check speculation by cutting off at the source the resources upon which the professional City operators draw. It would be part of the policy of the National Banking Corporation to ensure that the legitimate demands of trade and industry for finance would always take precedence over those for purely financial Stock Exchange operations, instead of, as at present, the requirements of the Stock Exchange frequently taking precedence over those of trade and industry, simply because the Stock Exchange operators can offer to the banks a more easily negotiable security.

The reliance upon paper security, while it is inherent in the present joint stock banking system, is one of the most serious

defects of that system, and one which can only be overcome by national control.

It is a defect which particularly hits the small man, who frequently finds it impossible to obtain the finance he requires from his bank for sound and desirable purposes, simply because the security he has to offer is not of a marketable nature, while, at the same time, plausible rogues of the Hatry calibre find no difficulty whatever in obtaining all the finance they wish from the banks.

In this connexion it is to be noted with interest that two of the commissioners appointed by the National Government to investigate the distressed areas, Capt. Euan Wallace, for Durham and Tyneside, and Mr. J. C. C. Davidson, for Cumberland, both referred in their reports to the difficulty experienced by small firms in these areas in obtaining financial facilities. And Mr. Davidson declared specifically that if finance could be provided for small industries in the distressed areas, it would make quite a considerable contribution to increasing employment.

Now it is obviously in the national interest that employment should be in-

creased, and that every proper assistance should be given to reviving industry in the distressed areas.

But for the very reason that those areas are distressed, industries operating there are not regarded as good borrowers by the joint stock banks as at present constituted.

Here is an obvious instance where the private control of the banks is in conflict with public policy, yet not one of the joint stock banks alone could be expected to go to the assistance of the depressed areas, for if it did, it might find a certain amount of its funds tied up for a longer period than normal, and thus find its position worsened in comparison with the other big banks.

On the other hand the National Banking Corporation would be able to spread the risk taken in the financing of industries in the distressed areas over the whole volume of banking business in the country, offsetting possible losses in the distressed areas against profits in the more prosperous districts, and being a public institution it would, if necessary, be possible to arrange a Government guarantee of some kind to cover the additional risk undertaken in

sponsoring such developments on lines similar in principle to the Overseas Trade Guarantees. Without banking assistance it is indeed doubtful whether industry can ever be revived in the distressed areas, or work ever found for the large number of unemployed in those districts. But such banking assistance cannot be given so long as the joint stock banks remain under private control.

One final word. It would be the primary responsibility of the National Banking Corporation to safeguard the interests of its depositors. So far from being weakened, the position of those depositors would be greatly strengthened, for they would have behind them the whole credit of the State.

Moreover, in the last resort their security, as indeed the economic security of us all, depends upon the industrial and trading prosperity of the nation as a whole. And such industrial and trading prosperity is impossible without a planned distribution of credit which will ensure that no industry serving a useful purpose in the national life suffers from lack of proper financial facilities.

It is because a National Banking Corporation would be able to provide those facilities, and because they cannot be provided otherwise, that the Labour Party puts this measure in its programme.

CHAPTER IV

THE MONEY MARKET

What the money market is—Its part in the 1931 crisis—How to prevent a repetition—Temporary finance for British industry.

BEFORE turning from banking questions to consider the organization of investment and long-term finance for industry, it is desirable to devote some attention to that mysterious organism known as the London Money Market.

The operations of the market are largely wrapped in mystery so far as the ordinary person is concerned, but they are nevertheless of very considerable importance to us all.

The London Money Market may be described as a kind of reservoir into which flows the unused money of the banks, insurance and trust companies, and of the foreign banks and financial interests engaged in international business.

It is estimated that the short-loan fund of the money market amounts to at least £300,000,000, and the money market which handles these funds is split up into two sections: "Discount Houses" and "Acceptance Houses."

The discount houses make their profits by buying short-term bills at a discount, their profit being the difference between the price they pay for the bill and the price at which it can be redeemed at the end of its life, after allowing for the rate of interest which they pay for the funds they borrow. To finance these transactions they borrow funds from the banks, and to a small extent from insurance and trust companies, and in the main their business at present consists of the purchase of Treasury Bills, which represent short-term borrowing by the Government.

They are also, however, prepared to discount bills of exchange for the financing of trade, whether for internal or foreign transactions, although this section of their business has diminished very substantially in recent years as the habit has grown up of financing home trade by bank advances instead of by bills.

The acceptance houses, of which there are about twenty, are nearly all of foreign origin and were originally international merchants, whose credit was so excellent, that bills accepted by them were regarded as absolutely sound, and would be taken by any one. They have now developed into what are known as merchant bankers, and earn substantial incomes by accepting bills for other people. This means that they lend their names for a commission, undertaking in effect to redeem the bills, if the original person issuing them fails to do so at the due date.

Now the London Money Market firms, and particularly the acceptance houses, are extremely international in their outlook. They devote themselves, or did, before the crisis, very largely to giving facilities and lending money abroad, and they have frequently lent to the foreign institutions which were directly competing with British industries, so that it has often happened that it was much easier for German industrialists to obtain financial assistance from the London Money Market, than it was for a British industrial firm engaged in similar business.

It was this foreign business of the London Money Market which precipitated the 1931 financial crisis in this country. At that time the London merchant bankers had large sums of money deposited with them by French banks and other Continental financiers, which were withdrawable at short notice. This money they had re-lent to Germany at a higher interest rate. Now, although it is the credit standing of the borrower that is the primary consideration of the London merchant bankers and acceptance houses, in fact, owing to the lack of co-ordination in the London Money Market, many foreign borrowers secured far greater credit than their financial standing justified. This they were able to do by going from one house to another borrowing from each without the knowledge of the other.

Consequently, when the German industrial and financial crisis took place, there was a rush by those who had deposits with the London merchant bankers to withdraw their funds from London, because they knew of the heavy commitments of these bankers in Germany.

The result was not only the complete

dislocation of the whole financial system but, as we know to our cost, the bankers were able to force the Government to embark on a wholesale policy of economy, which, while it saved the bankers, inflicted starvation and hardship on millions of British citizens and brought ruin to innumerable enterprises. It is, indeed, remarkable that the nation should have tolerated so complete an inversion of public policy, and that no effective steps should even then have been taken to bring this domination by financial interests to an end.

It is obviously essential that such a situation shall not be allowed to arise again.

Fortunately, it is within the power of the Bank of England to enforce a very complete control of the money market, and rigid control would be enforced by a nationalized bank.

Such control is possible by reason of the fact that acceptance houses make their money by lending their names on bills of exchange for a commission, and that the value of that name depends above everything else upon whether, or no, it is regarded as good by the Bank of England. Moreover, the bank can refuse to discount any

particular type of bill, and if it is known that such a bill cannot in the last resort be discounted at the Bank of England, then it will not be dealt in generally on the money market.

A nationalized Bank of England would insist upon the fullest information being provided by the acceptance houses as to the type of business they were undertaking, and the volume and nature of their foreign lending, and would not allow that total to reach dangerous limits.

It would, moreover, take measures to ensure that the large funds in the London Money Market should be used more extensively for the purpose of assisting British industry. This type of short-term financing by bills would undoubtedly prove very suitable for some of the operations of British firms, such as cover during the movement of goods. In addition to Treasury bills, which run for a period of three months, the discount houses hold many millions of Government bonds, repayable during the following three years, and they could equally take up one to three-year bonds of public corporations and public utility companies, which need

temporary finance of this nature. Money for such periods as this cannot easily be provided by the ordinary banks, nor can they be obtained through the ordinary capital market because the investor wishes to obtain a more permanent investment.

In addition many large municipalities could often with advantage do a part of their financing by the issue of short-term bonds and bills. Some corporations, such as Liverpool and Glasgow, Edinburgh and Sheffield do so at present, but this system could be extended with great advantage, in view of the fact that it is always cheaper to borrow for short than long periods, so that where money is not required for permanent purposes, there is a substantial saving to be made by the issue of short-term bonds of this character. The nationalized Bank of England would be able to see to it that this type of business was encouraged by the money market. There is also a substantial amount of export business which could be financed in this way.

In order, therefore, to ensure both that there shall not be a repetition of the unsound foreign financing by the London

merchant bankers which precipitated the 1931 financial crisis, and also that a much fuller use of the facilities provided by the London Money Market shall be available to British industry, it is essential that the money market should be brought under greater control, and worked to a much more co-ordinated plan.

Such planning and such control would be made possible by the supervision of a nationally controlled Bank of England, to the great advantage of industry and commerce.

CHAPTER V

CAPITAL AND INVESTMENT

Importance of new capital market—How the market works at present—The Stock Exchange—Brokers and jobbers—Permission to deal—‘Bulls’ and ‘bears’—How banks help speculation—The waste of capital—How a boom begins—And slump inevitably follows—The vicious spiral—Signs of a new boom—Foreign lending—Evils of unsound foreign loans—The National Investment Board.

IMPORTANT as is the provision of short-term capital for credit and industry, that of raising capital of a more permanent nature is perhaps most important of all.

The long-term capital market is indeed at the very heart of the modern capitalist system, for through it joint stock enterprises obtain the capital for their businesses by securing the investments of private

capitalists who expect to make a profit. If investors are not prepared to lend money, capitalism cannot continue, yet the arrangements by which capital is raised are grossly inefficient. They allow an enormous wastage of investors' money and serious upsets to trade, simply because of the absence of any central control, or of any attempt to ensure that the national savings are utilized in the most useful manner.

The purpose of a new capital market is to act as a sort of middle-man between the investor and industry ; between those who have money which they do not require for their own immediate purposes and are prepared to invest, and those companies or institutions which desire to borrow money to carry on their businesses or to develop them.

If an industrial company wishes to raise fresh capital, it approaches an issuing house, which undertakes to bring out an issue of capital, which may be in ordinary shares, or preference shares, or debenture stock.

The prospectus is then drawn up setting out the company's business, its record, and giving estimates of future profit. This

prospectus is published, and investors are asked to subscribe for the shares or stock.

Sometimes a sufficient number of investors are not attracted by the prospectus terms to apply for the full number of shares, and so, to insure that the industrial company shall still secure the capital it requires, the issuing house normally arranges for the issue to be underwritten.

This means that various institutions in the City, finance houses and the like, undertake for a commission to purchase such of the shares as are not applied for by the public.

In cases where the issue is fully subscribed by the investing public, the commission paid to the underwriters is, of course, sheer profit to them. In cases, however, where the issue is not fully subscribed, they may find themselves called upon to take up a substantial block of shares, which shares they will later endeavour to sell in order to get back their money.

As no investor can, in the normal course of things, know when circumstances arise which may make it necessary for him to realize his capital, and as obviously it

would lead to all sorts of complications if the investor in the shares of a company had a right to go to that company and demand repayment, there is a market in which shares can be bought and sold. That market is the Stock Exchange.

After a public issue of new capital has been made, permission to deal in the new shares is obtained from the Stock Exchange. That means that the shares can be bought and sold on the Stock Exchange, in the same way as a commodity can be bought and sold in any other market.

While the Stock Exchange does exist in theory to facilitate investment, by providing a free market for stocks and shares, and while such a free market is obviously an essential feature of any system of finance by private investment, in practice a large part of Stock Exchange business usually consists in speculative, rather than purely investment, dealings.

In order to explain the present position and make clear the reason why the Labour Party considers control of the long-term capital market to be necessary under a National Investment Board, we must devote a little time to the organization of the

Stock Exchange, and of the new issue market generally.

The total membership of the Stock Exchange is just under 4,000, and this membership is divided into two classes, jobbers and brokers.

Despite the importance of the business, no professional or technical qualifications, or special training, are necessary for membership. Nor is even a substantial deposit of funds as a safeguard against insolvency required, as in the case of an insurance underwriter who is a member of Lloyd's.

All that is required is that the applicant for membership shall be British, shall not be bankrupt, and shall be able to obtain three existing members as security for £500 each for four years. The candidate for membership must then buy the nomination of the retired or deceased member. These nominations are bought and sold like stocks and shares and cost anything from £50 to £1,850, according to the market price, which varies with the profitability of Stock Exchange business at the particular time.

In addition the prospective member has to pay an entrance fee of 600 guineas, and an annual subscription of 100 guineas, and

must buy three shares in the Stock Exchange Company, which is a private company run for profit. The Stock Exchange is governed by a committee for general purposes, which is elected annually. All the members of the committee retire at the end of the year, but in practice all who wish to stand again are usually re-elected.

This committee has completely autocratic powers, both over the professional conduct of members of the Stock Exchange, and in deciding whether or not the shares of any company shall be dealt in on the Stock Exchange.

It gives no public explanation of its decisions, which cannot be challenged by members.

The important nature of the Stock Exchange can be gathered from the fact that the nominal value of the securities quoted on the Stock Exchange Official List is well over £18,000,000,000, while in addition there are a large number of securities which are dealt in, and are included in what is known as the Supplementary List.

Of the two classes of members, jobbers and brokers, the jobber is a dealer in

shares on his own account, while the broker is an agent acting on commission for a client.

The jobber makes a market in shares, buying them from brokers in the hope of reselling them to other brokers, and depends for his profit on the difference between buying and selling price. He may thus be described as a merchant or middle-man in shares.

The broker, however, deals direct with the public, and is engaged as an agent to negotiate sales or purchases. His income comes from the commission he charges, based on a percentage of the value of the stocks or shares dealt in.

There being no guarantee fund provided by the Stock Exchange as a whole to safeguard clients against loss—clients have no claim except against individual members.

In view of the fact that one of the great attractions to the investor of putting money in stocks or shares is that his money is easily realizable, because of the free market which exists in such securities—a much freer market than exists, for instance, in property—the power to grant or withhold permission to deal in shares on the Stock

Exchange, exercised by the Stock Exchange Committee, is a very important one.

Acting under the general purposes committee, there is a share and loan department of the Stock Exchange, and a most important part of its business is to examine all prospectuses of new issues, and all other available documents regarding securities in which permission to deal is sought, and to advise the Stock Exchange Committee whether this permission shall be granted or not.

Yet the utmost mystery prevails as to the manner in which this important function is exercised, and permission has been granted to many issues which were undesirable in every way. For some unaccountable reason the committee refuses to make publicly known whether permission to deal in the shares of a particular company will be granted or not, until after the issue is made, and the investor has parted with his money. The result is that the prospectus of every issue carries the same legend: 'Application for permission to deal in the shares will be made to the Committee of the Stock Exchange in due course,' and while those 'in the know' may be

aware that the Committee has already intimated that permission will not be granted, the ordinary investor gets no kind of guidance or protection whatever.

For the last year for which full statistics are available some 1,172 applications for permission to deal in shares on the Stock Exchange were granted, representing securities to a total nominal value of £811,449,000. These figures will give some impression of the importance of the Stock Exchange business, and the extent of the committee's power.

Dealing in securities on the Stock Exchange is not done on a cash basis except as regards British Government, Dominion, provincial and colonial Government securities. In all other securities the settlement of transactions does not have to be made until the end of the current Stock Exchange account, the account being usually of a fortnight's duration, although there are certain restrictions on dealings in bank shares. Thus the person who buys the shares at the beginning of an account, in anticipation of a rise—he is usually called a 'bull' of the shares—has a fortnight before he need find the money to

pay for them, and before that time comes, he hopes to be able to resell at a profit. Similarly the person who believes that certain shares are likely to fall in value—he is known as a ‘bear’ of the shares—may give his broker instructions to sell a block of these shares, though he does not actually possess any of them. He knows, however, that he will not have to deliver the shares he has sold until the end of the account, by which time, if his expectations prove correct, and the shares have fallen, he will be able to buy the number of shares he has undertaken to deliver at a price well below the figure at which he sold at the beginning of the account. As a fortnight is frequently not long enough for share activity to get going thoroughly, the Stock Exchange provides additional facilities to speculators by providing what are known as ‘carry over’ facilities.

Under this system if a ‘bull’ operator, for instance, finds that the shares he has bought have not risen sufficiently to yield him a profit on the sale, and if he does not wish, or is not able to find the money to pay for the shares outright, he can arrange to postpone settlement by having

the transaction carried over to the end of the next account.

For this facility he pays a rate of interest termed a contango rate. He may even go on carrying the shares from one account to another for a very considerable period, without ever being under the necessity of having to find the money for them.

Similarly a 'bear' operator who has sold shares which were not actually in his possession, can, if the shares have not fallen sufficiently in value for him to buy and cover himself, postpone delivery from one account to another.

This system of carrying over shares from one account to another is the principal method by which speculation is conducted on the Stock Exchange, although in addition some speculation is financed by the banks on what is known as margin.

For example, a bank will agree to take up shares on a client's behalf, the client finding a percentage of the purchase price as a margin. If the shares fall the banks will demand a bigger margin to safeguard themselves, and if the client cannot find the money to increase the margin, they will sell.

There is no doubt whatever that at the

present time the main volume of Stock Exchange business, except in Government securities, and bank shares which are subject to certain restrictions, is speculative, and only a small proportion of the present membership of the Stock Exchange would be needed to carry through straightforward investment business. Moreover, for obvious reasons Stock Exchange members encourage speculation, the broker because of his commission on each deal, and the jobber because an active market in shares makes it easier for him to buy and sell at a profit, and thus enables him to avoid having in his possession shares which he may find it difficult to resell.

There is also one other form of speculation: the operator pays an option rate, in consequence of which he acquires the right to buy shares at a fixed price on a future date, or alternatively, he may acquire the right to sell shares at a fixed price on a future date.

Before examining the effects of speculation in stocks and shares, and how it affects the whole community, let us return to the actual business of making new capital issues.

In recent years there has been developed a somewhat different method of raising fresh capital ; for instead of a public issue being made, the whole of the issue of stocks or shares is bought up by a financial syndicate, which usually includes one or more Stock Exchange firms.

This syndicate pays a certain price for the shares, and arranges for dealings to commence on the Stock Exchange at a figure sufficiently above that which the syndicate paid, so as to yield a handsome profit.

Now clearly the ordinary investor, and particularly the small investor, cannot know a very great deal about many of the companies which appear before the public inviting subscriptions for fresh capital.

He very probably has not the training to analyse fully the statements made on prospectuses, and even if he had, the information given may be insufficient to enable him to make an adequate judgement.

He must rely, therefore, to a very considerable extent upon the honesty of the issuing houses, and Stock Exchange firms concerned, and this is particularly necessary where capital issues are made by recently

formed companies, which have no past record to go on.

There are, one would think, two considerations which would dominate the minds of the issuing houses and of the Stock Exchange.

One is that every attempt should be made to avoid producing upset and chaos in existing industries, in consequence of the flotation of large numbers of new concerns whose existence cannot be justified by the actual or potential demand for their products, and whose entry into the market must, therefore, create uneconomic competition, and lead to distress all round. And the second is the avoidance of losses on a large scale by investors, owing to the flotation of unsound companies, or to the over-capitalization of existing concerns.

But in actual fact both these considerations are completely ignored by the new issue market of the Stock Exchange, which, as has been shown again and again in the past, concerns itself only with the possibility of immediate profits without any thought of the future.

In the last Stock Exchange boom, we learn from the Macmillan Report, £117,000,000

of new capital was raised in one year, and out of this £50,000,000 was completely lost within a short period, while out of 284 new companies floated, seventy were in liquidation within two years, and the capital of thirty-six others was of no ascertainable value. That, of course, is not the whole of the story, and does not give any idea of the whole amount of the damage done.

Many of the shares of these companies which soon failed, rose when they were first issued to extravagant heights on the Stock Exchange, and were bought by investors at far above their real value. They were the subject of huge speculation, which made profits for some people but losses for many more. Moreover, as a result of that speculation, industries were disorganized, sound established firms were faced with difficulties, and unemployment was increased.

Let us consider what happens during a boom period on the Stock Exchange, and how a disastrous slump inevitably follows, and we shall see how great is the necessity for some control of the capital issue market.

A boom usually starts from an increase of activity in a certain industry or industries,

possibly owing to some new inventions which lead to a big increase in technical efficiency and a reduction in costs, or to the opening up of a new market.

The industries particularly affected by these technical improvements, or the opening of new markets begin to announce higher profits. The last boom began with the gramophone and artificial silk companies, in consequence of great technical developments and of the general increased public demand for their products. Both of these industries were comparatively new, and these developments led to a big increase in profits and a rapid rise in the market price of the shares of the companies concerned.

Now a rise in a number of shares under the present system has two effects. Those investors who held the shares originally and have made money out of them, begin to feel more optimistic and those who did not hold the shares begin to look around to see if they cannot make similar profits in some other direction. As a result the activity in a certain section of the market begins to overflow into other sections, and if it continues long enough there is likely to be a

general rise in all shares, as those who have made profits begin to buy other securities.

This rise is helped on by the professional operators, the 'bulls,' who see a chance of working markets up, and of attracting the general public to their own advantage. In the general air of optimism which is created by rapidly rising profits, even in a few sections of industry, it is easy for the professional operator to get to work. The times are with him. The smell of quick profits is in the air.

The company promoters and issuing houses begin to get busy. They see that a great public appetite for shares has been created, and they perceive, in particular, that because established companies in certain industries have made increased profits, many investors will be only too anxious to buy shares in new companies in the same industry. There begins, therefore, a rush to bring out prospectuses of new companies, which claim that they will be able to make at least as big profits as the established companies. New companies are formed, private businesses are turned into public companies with greatly increased

capital, a large proportion of which goes into the pockets of the previous owners as payment for 'goodwill.'

Prospects of enormous profits are dangled before the public, while the professional company promoters rake off huge sums in promotion profits. The professional operator helps on the good work by applying for the shares of the new flotations in large numbers, in the confident belief that he will be able to sell out at a higher price as soon as dealings commence on the Stock Exchange. His operations, together with the public demand for shares, lead to issue after issue being heavily over-subscribed, and those who are unable to obtain the shares when they are originally issued, rush to buy them as soon as business in them begins on the Stock Exchange.

The consequence is that where there were formerly a few sound companies in an industry, there is a sudden rush of new creations. As no deliberate effort is made to expand consumption it is quite impossible for the demand for the goods to keep pace with this sudden, and quite illogical, jump in productive capacity.

Moreover, because shares of companies

in a few particular industries, like the gramophone and artificial silk industries, are of a luxury or semi-luxury character, and are attracting so large a proportion of investment in the hope of quick profits, it becomes increasingly difficult for sound companies in other industries, possibly of more permanent importance to the national well-being, which cannot hold out any hope of wildly extravagant profits to secure capital for proper development. They may offer a steady return on the capital invested, but they cannot compete with the fantastic figures which appear in the prospectuses of all kinds of mushroom companies.

But because there has been no attempt to plan investment, or to relate consumption to production and to ensure an orderly development of new industries, the boom does not last.

As the new companies come into production, output increases beyond the capacity of the market, with the result that there is a glut. The immediate consequence of this is that the new companies find that their profit estimates are all wrong, and in a desperate effort to meet the situation they start cutting prices right and left.

Even that rarely saves them ; they are forced into liquidation and close down. But before that happens the original established companies have had to meet this competition by themselves cutting prices in self-defence, with the result that there is a general price-cutting war and a sharp reduction in profits.

As profits begin to fall there is a general decline in the value of industrial shares on the Stock Exchange. The decline is led by the shares which have boomed most previously, and their holders are faced with heavy losses, and are forced to sell other sounder shares to meet those losses, with the result that the slump becomes general.

As was pointed out earlier, a large amount of Stock Exchange business is done on loans from the banks. And as securities fall the banks begin to restrict their lending, and to demand the repayment of loans previously granted because the cover which they hold in the form of shares is no longer sufficiently good. Thus the selling of Stock Exchange securities gathers pace, whilst industrialists and merchants who have raised loans, either on the security of goods or investments, also have to start selling in order

to repay bank loans, for fear of a further fall in values which may render them insolvent.

The movement which has been called the 'vicious spiral,' wherein lack of confidence produces falling prices and falling prices in their turn increase the lack of confidence, has begun.

And as lack of confidence spreads there comes a growing disinclination to buy goods or to invest money, for fear of a further fall in values.

At the same time the disorganization created in industries by the earlier price cutting leads to further closing down of factories, and the throwing of people out of work. Falling profits bring a lower yield to the Government from taxation, and inspire policies of general economy which again increases unemployment by still further restricting purchasing power, and helps to increase the depression.

Thus the complete failure to control the flow of investment in the first place, and the readiness of company promoters, issuing houses and members of the Stock Exchange to work up a boom, have the most serious and widespread consequences upon the

whole economic structure and affect the lives of the entire population.

Upon investors themselves it inflicts enormous losses.

In each year between 1927 and 1931 between two and six times as much money was raised to take over existing assets at substantially inflated values as was raised to build new factories or plants, while a very high proportion of the money put up by investors was dissipated in greatly exaggerated new issuing expenses, instead of being used for definitely useful purposes.

It may seem that we are referring to the bad old days, and it may be thought that the City has learnt a lesson from the last boom and the slump which followed. But there is unfortunately no indication that this is so. There has been almost identically the same sort of boom recently in new gold-mining companies, in consequence of the rise in the price of gold. Although the Stock Exchange Committee has been a little more careful in regard to the companies whose shares it allows to be dealt in on the Stock Exchange, nothing has been done to control company flotations.

That the practice of taking large profits on public flotations continues can be seen from two comparatively recent issues.

There is, of course, nothing improper in what was done, for those concerned followed recognized City practice, and no blame attaches to them; nor do these companies carry on basic national industries, but these issues are recent instances of methods which disorganized the cotton industry after the war.

One is a company called Griffiths Hughes Proprietaries Ltd., formed to take over a business which manufactures and sells proprietary medicine, including the well-known Kruschen Salts.

This company originally had a share capital of £172,350, held by sixteen people. When the new company was formed that capital was increased to £2,500,000, the original sixteen shareholders receiving for their shares £1,000,000 in cash and 1,499,993 ordinary shares of a nominal value of £1 each in the new company. The £1,000,000 cash payment was obtained by the promoters of the new company by a public issue of 1,000,000 £1 preference shares at 20s. 6d. a share, the 6d. per share premium providing the £25,000 working

capital which it was considered the company needed.

But, in addition, the original shareholders agreed to sell 500,000 of the new ordinary shares to the Stock Exchange firm which had headed the promotion syndicate, for a price of £1 per share in cash. What happened subsequently is both interesting and significant. The Stock Exchange firm which had obtained the shares for £1 each sold them to certain jobbers on the Stock Exchange for about 26s. per share. The jobbers in their turn sold them to a number of selected brokers for about 33s. per share. These brokers sold them to favoured clients for around 37s. per share and it was then arranged that dealings should commence on the Stock Exchange in the shares at 40s. per share. When dealings actually began the price rose to 42s. per share.

As a result there was a total net profit of £450,000, even after allowing for various expenses, and that profit was distributed amongst a few people in the City in the short space of fifteen days from the signing of the first contract for the formation of the new company.

To show that this is not an isolated

instance, it was followed by an issue of shares in a somewhat similar company, Eno's, the makers of Eno's Fruit Salts and other proprietary articles. In this case a profit of £360,000 was made by the issuing house responsible for the flotation, that figure representing the difference between the price paid by the issuing house to the company and the figure at which it was sold to the public. The time taken by this deal was three weeks.

While these huge profits are reaped by the financiers concerned, an industry which has been the subject of such transactions must henceforth strive to make a profit on a vastly increased capital.

This lack of any control over the flow of investments leads, not only to the upset of the balance of production and consumption to which reference has been made, and to the useless wastage of the savings of a number of people for the large profits of a few, but to a much greater export of capital from this country than is economic.

No attempt has ever been made in the past to decide what proportion of the total national savings was required for internal

industrial and development purposes, and what percentage, if any, could safely be invested abroad. Instead, large foreign loans were floated on the London market, often for purposes which would mean direct competition with British industry, or to carry through projects for which there was no real justification.

Sir Arthur Salter, in his book *Recovery*, draws particular attention to the evils which result from unregulated foreign lending. He says (page 104): 'The offering of money to public borrowers by persons with no political responsibilities can constitute a grave public danger.' He instances the substantial loan to Bolivia which was made a little time prior to the outbreak of hostilities between Bolivia and Paraguay. This loan was nominally for the construction of railways, but the money was expended upon armaments. Referring to the Brazilian default, Sir Arthur Salter points out that since the war foreign loans to the Government, states and municipalities of Brazil have amounted to about 800,000,000 dollars, and that these sums included 15,000,000 dollars for the bodily demolition of a hill in Rio, 25,000,000

dollars for electrifying the Central Railway of Brazil, which has not yet been electrified, and 20,000,000 dollars or more for a water supply scheme which was abandoned.

Thus huge over-lending of British investors' money abroad has not only resulted in enormous losses to British investors themselves, and to the withdrawal of capital from this country which could have been used with greater advantage at home, but it has placed many foreign countries under a burden of indebtedness which they cannot sustain.

As one example of this, Bolivia before she defaulted, as so many other countries have defaulted, on her indebtedness found that 72 per cent of her total national revenue was needed to pay interest on past debts.

And it is obvious that if countries overseas, which are the natural market for British exports, find so large a proportion of their national income required to pay interest on past debts, often for uneconomic purposes, they cannot continue to purchase goods. The result is that ultimately our export market suffers, and the numbers of the unemployed in the great exporting

industries of this country are still further increased.

No impartial person who considers such facts as these can for one moment, I suggest, doubt the necessity for some control of investment.

The Labour Party proposes—and in this proposal has the support of a large body of expert opinion, including Mr. J. M. Keynes, the famous economist—the setting up of a National Investment Board.

The National Investment Board would not be a political body, nor would it be a sort of joint committee of the present City vested interests.

It would be a Board of full-time, first-class experts appointed by the Government on grounds of ability and experience and willingness to undertake this important and responsible task.

It would be assisted by a permanent staff of economists, statisticians, and business specialists.

It would be charged with the duty of replacing the present chaos and waste which have been described by a properly planned and ordered system for the raising of new capital. It would make it possible

for investment to flow into sound projects of national benefit, and would see to it that the proper requirements of public and industrial development at home were met before British money was sent overseas.

For this purpose it would be given the legal right of licence for any issue of capital, and no issue would be permitted unless the licence of the Board had first been obtained.

The Board would co-operate with the Government and the State Departments, with the municipal authorities and with the public boards, such as the Central Electricity Board, and the London Passenger Transport Board, and in consultation with them it would estimate the total amount of new capital which would be required for these public purposes during the year.

It would also be in close consultation with the great basic industries, such as coal, cotton and wool, shipbuilding and engineering, and similar estimates of their needs for capital would be prepared. On the other hand, the experts of the Board would calculate the total amount of money likely to be available for investment each year. These calculations are already made

for various purposes by statistical experts employed by the banks and at the universities. According to Mr. Colin Clark, the total amount available for investment in a normal year is in the neighbourhood of £400,000,000 ; of this some £200,000,000 is accounted for by the investment of companies' undistributed profits, and another £130,000,000 by the sinking-fund investments of State and municipal authorities.

Having arrived at these estimates of major capital requirements on the one hand, and of public and private funds available for investment on the other, and having tested them by reference to the general plans of national economic development and the current information of investment tendency, the Board would be in a position to arrange the granting of its issuing licences in such a way that the most urgent and publicly necessary capital needs would be given priority, and the undesirable issues of a boom period would be avoided altogether.

When these primary conditions had been fulfilled licences would be issued for the raising of capital for other home purposes

by British companies, and finally for foreign loans if a surplus were available.

While it would be no part of the function of the National Investment Board to guarantee the interest or dividend in capital issues, it would certainly refuse to license the wild-cat schemes of speculative investment which eat up the savings of the small investor at the present time.

But it would not only improve the security of the investor, but also ensure greater stability for industry, by preventing too large a flow of capital into one industry to the ultimate disaster of that particular industry, and to the disadvantage of other industries which are thereby starved of capital for proper development.

In co-operation with the National Banking Corporation it would restrict wild speculation, both by the greater control of new issues, and the prevention of a spate of unsound new company flotations, and by advising the Banking Corporation as to what restrictions on lending for purely Stock Exchange purposes were desirable.

In view of the fact previously stated that a very large percentage of Stock Exchange speculation is only possible because of bank

financing, the National Banking Corporation in co-operation with the National Investment Board could bring the worst speculative excesses to an end without any difficulty whatever.

The powers of general supervision and regulation of investment by the National Investment Board would also apply to the character and direction of the investments of the insurance companies, and other institutions who have large funds for investment. It is calculated that the big insurance companies together handle some £1,000,000,000 of policy-holders' money, of which the greater part is invested in Stock Exchange securities.

It is estimated that approximately £50,000,000 is saved each year through the medium of the insurance companies, and a large proportion of this represents the savings of many hundreds of thousands of small people who have no other form of saving.

As a result of their handling of these huge funds, the insurance companies have a very great influence on the investment market.

It is clearly, therefore, only right that

the savings of large numbers of small people, the majority of them in industrial employment, should be used as far as is necessary and possible in ways which will be of genuine assistance to industry.

The insurance companies, indeed, at present represent some effort to plan the investment of the community's savings so that the supervision of their investments by a National Investment Board is a logical development of their functions.

The functions of a National Investment Board are here given only in comparatively broad outlines.

The Stock Exchange would, however, need to be re-formed as a subsidiary organization to the National Investment Board, and a guarantee fund should be set up by the Stock Exchange to safeguard investors against losses owing to the failure of individual brokers. It would become what it was originally intended to be—a market for investment, instead of a centre of speculation.

In addition the National Investment Board, in co-operation with the National Banking Corporation, would devote itself to the task of providing better financial

facilities than exist at present for small and medium-sized firms, which cannot interest the present issuing houses because the capital they require is not sufficiently large to provide those issuing houses with a big profit on the transaction. It might set up, for instance, a subsidiary credit corporation for financing small firms, and an agricultural credit corporation for financing agricultural developments. It would work throughout in co-operation with the industrial and economic bodies set up by the Government, to ensure a national planning of our economic life for the general benefit.

CHAPTER VI

TO SUM UP

WE have now examined, in very broad outline, the working of what we have called our banking and financial system. For the sake of brevity and simplicity a great deal of detail which would be familiar to those who take any part in running this complicated mechanism has been omitted, for it is essential that the ordinary reader shall be able to see how the system works and how it affects him. Few will deny that the present arrangements are wasteful, haphazard and injurious to the public welfare. Yet it must not be supposed that the men who run the institutions we have described are incompetent, or that they are so blindly selfish and anti-social in their outlook that they would deliberately ruin the nation for their own private gain. On the contrary, among those engaged in banking and

finance are very many able minds and acute brains, and it would be difficult to find anywhere more capable, devoted and reliable people than those who make up the staffs of the banks and other financial organizations. Among them, in all grades, are large numbers who are honestly perplexed and dismayed by the evil consequences of a system in which they give loyal service in their own particular corner. They would be among the first to welcome reforms which would give them the opportunity of using their ability and experience for the welfare and enrichment of the nation.

It is very clear that if we are to escape from the appalling paradox of great poverty amidst unused abundance, and the intolerable spectacle of millions of workers unemployed, while the majority of the people go short of the things which those out of work ought to be making, it will only be done by some general public planning of our economic life.

We have got to see to it that people are able to buy the goods which we can produce. We must make producing and using balance. This we shall never be able to do until we

are able to use, as a part of a general scheme of national development, the enormous power which the control of the volume of money and credit gives.

We cannot, therefore, allow this vital power to remain the prerogative of a private institution, to be used in the interests of a special trade—the trade in money and credit itself.

So the Bank of England which in this country controls the amount of money and credit available must be transformed from a private company into a national institution, playing its vital part in the organization of prosperity for all.

This could be achieved very simply by giving the Government the right to appoint the governor and the other members of the Board, and by the Government acquiring the capital of the bank by suitable compensation to the present stockholders.

But it is not enough that there should be public control only of the volume of credit. It is equally necessary, if successfully planned development is to replace the defects of unregulated competition, that there should be control of the use which is made of credit. It is, therefore, essential

to devise the best method of exercising effective public control over the joint stock banks, whose proper function it should be to provide short-term finance to industry.

As there is at present a great deal of waste and overlapping owing to the competition of the "Big Five" among themselves for the same class of business, and an unnecessarily large number of directors, it is proposed to amalgamate these banks into a single National Banking Corporation under public ownership and control. Here also the Government would probably acquire the right to appoint the directorate, which would be comparatively small, and composed of first-class men of ability and experience, the managers and staffs continuing in their present employment.

There would be the closest co-operation between the Bank of England and the National Banking Corporation, and both would work in harmony with the general economic policy of the Government. But while the Government would indicate the general line of banking policy to be followed, the National Banking Corporation and its officers would be given wide discretion in

their relations with individual customers, especially private companies, firms and individuals. There would also be the strictest obligation to safeguard the interests of their depositors.

Important as it is that the policy of the banks shall be subject to public control, it is no less important that there shall be a radical alteration in the system of raising new long-term capital for industry. Indeed, the present arrangements are so haphazard as to be scarcely worthy of being described as a system at all.

We have seen that there is gross wastage of our new capital resources, that large numbers of people are legally robbed of their savings, and that the essential business of gathering the nation's savings, and directing them into investment in the necessary plant and equipment of wealth production, is made the subject of wild speculation and gambling. Devastating slump inevitably follows these artificial booms with terrifying consequences to the entire nation. All attempts to reorganize our resources for the public benefit will fail unless we can ensure that the national savings find their way into investments of

a desirable character from the national point of view.

For that purpose it will be necessary to create an entirely new institution, a National Investment Board, armed with the power to control all new issues of capital by the granting of licences without which no issue could be made. It would thus be able to arrange that vital national industries were not starved of capital while other enterprises were over-capitalized, and that money required for housing was not diverted into building dog-tracks. It would decline to sanction a foreign loan which would have undesirable consequences at home, and it would give to the investor a protection which he has never hitherto enjoyed.

With the co-operation of the National Banking Corporation speculation would be effectively checked, and the Stock Exchange, which would probably become a subsidiary of the National Investment Board, would perform its proper function as a market for securities, instead of an organization for gambling.

A drastic reform of the present law relating to joint stock companies is also long overdue. The Companies Act of 1929

left many loopholes of which the directors of doubtful companies have not been slow to take advantage. The growth of the system of holding companies with a family of subsidiaries calls for new regulations regarding the publication of accounts and the disclosure of the actual owners of a company capital. The gross abuse of the proxy system needs to be dealt with, if any vestige of effective control by the owners of company capital is to remain. No less urgent is an overhaul of the laws under which so-called industrial and friendly societies operate. These acts, which were intended for the regulation of workmen's friendly societies, unfortunately provide a convenient shelter for the particularly odious kind of financial rogues, who prey upon the savings of the poor.

These, I believe, would be the steps which a Labour Government would take in order to make the best use of money credit and investment for the public welfare. They are essentially part of a Socialist programme of national development.

I believe that they would have the general support of an unexpectedly large body of City people, and that they could

be put into effect without any upheaval or interruption of business. Although the Government would naturally be armed with effective powers of compulsion, I am convinced that any active opposition would be negligible.

The British people have a peculiar genius for quietly effecting radical change, and it could be no more profitably employed than in fashioning some public order from the present chaos in the City.

PRINTED IN GREAT BRITAIN BY
WYMAN AND SONS, LIMITED,
LONDON, FAKENEAM AND READING